A STUDY OF THE INDIAN MONEY MARKET

WITH PARTICULAR REFERENCE TO THE CALCUTTA MONEY MARKET

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IN MEMORY OF
MY FATHER

PREFACE

THIS book is an attempt at a comprehensive and critical study of the Indian money market, with particular reference to conditions in the Calcutta market. It is essentially a descriptive, not a historical, account. Its justification is that there does not exist, as far as I know, any adequate study of the Indian money market as a whole, or of any of our principal markets. All up-to-date enquiries have been concerned primarily with the development or the existing position of our banking system.

Any systematic enquiry into the working of the Indian money market has to contend with many handicaps. For one thing, there is not in India *one* single money market reflecting the financial and economic condition of the whole country. It is indeed not quite correct to speak of the Indian money market as one may of the London or even the New York money market. For another, statistical information in this country is still far from satisfactory. The lack of published statistics has sometimes had to be made up by information obtained by personal enquiries and from private sources. In this, I was considerably helped by the experience I had gained and the contacts I had made during the period I was associated with the Comilla Banking Corporation Ltd. In fact, I began first to be interested in the study of the conditions and problems of our money market while serving this institution, and this interest received a further stimulus as a result of my subsequent association with Calcutta University as a lecturer on 'Practical Banking'.

This study is divided into three parts. The first part is devoted to a critical examination of existing material and a descriptive account of the institutions of both the

organized and the bazaar sections of the money market, and covers common ground for any money market in India. The second part deals with the work of the Reserve Bank as the controller of credit and the operations of the two sections of the money market with special reference to conditions in Calcutta, and also attempts at an assessment of the resources of the Calcutta money market. The third part discusses the long-term capital market and also provides an estimate of the annual investment of the Calcutta capital market. In the absence of adequate statistical information, this estimate as also the assessment of the resources of the Calcutta money market can only be very tentative.

This book, except the last chapter, was completed in August 1941. It does not, therefore, incorporate changes that have taken place since then.

My debts in writing this book are many. From Dr M. M. Roy and Professor J. P. Niyogi, both of whom have kindly read the whole book in manuscript, I have received constant help and many valuable suggestions and to them I cannot adequately express my indebtedness. I also acknowledge my debt to Mr C. S. Rangaswami, Managing Editor of the *Indian Finance*, with whom I have had many long and instructive discussions on the actual working of money markets in India, and to Mr G. W. Tyson, C.I.E., Editor of *Capital*, for permission to read the old issues of the journal as also for help received from him.

Extant literature on the working of the bazaar section of the Indian money market is very scanty. It is particularly difficult to collect any statistical information. What facts have been stated here about the bazaar money market in Calcutta have been gathered by personal discussion with a number of indigenous bankers and moneylenders. Among them, Mr Khan Chand of Messrs Begraj Tahalram, and

Mr Tribhuvandas Bajaj of Messrs Nandramdas Kanyahalal deserve special mention, and to them I offer my grateful thanks.

I am also indebted to the Hon'ble Mr N. R. Sarker, Commerce Member of the Government of India, for his encouragement to the pursuit of economic studies generally and the use of his well-equipped private library. I also acknowledge my debt to Mr H. C. Sarcar, Agent of the Calcutta Branch of the Comilla Banking Corporation Ltd., for placing unreservedly at my disposal his intimate knowledge of conditions in the Calcutta money market. I should also like to express my sincere thanks, for help received in various forms, to Mr J. C. Sen, until lately Agent of the Calcutta Branch of the Comilla Union Bank Ltd., Mr A. C. Watkins of the Chartered Bank of India, Australia and China Ltd., Mr A. K. Sen of the Bank of India Ltd., Mr H. C. Paul of the Calcutta City Bank Ltd., Mr D. Ghosh of the Department of Industries, Bengal, and Prof J. Kellas.

I need hardly add that nobody but myself is responsible for the opinions expressed in this book.

CALCUTTA
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BIMAL C. GHOSE

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PART I

CHAPTER I

INDIAN BANKING AND MONEY MARKET IN THE TWENTIETH CENTURY

A BANKING system or a money market, of which it is the most important constituent, can have no significance except in the context in which it operates. A monetary and banking system does not function in a vacuum. It must be related to the underlying economic realities of the country it serves. At the same time, money and banking do not play an entirely passive rôle in the economic system. They profoundly influence, and are influenced by, many features in the general economic environment.

The Economic Background

Some relevant statistics relating to economic conditions in India during the present century are detailed in the accompanying table. Their salient features may be briefly recapitulated. The first pre-requisite to rapid industrial and commercial development was assured by the end of the nineteenth century by the great progress effected in the means of transport and communications. By 1900 the greater part of India's present railway system had been completed. India had about 25,000 miles of railways in 1900-01 compared to about 43,000 miles in 1932-33. But the development since 1900 has been mostly in the shape of links between the main lines, or branch or feeder lines. There were 37,000 miles of metalled and 136,000 miles of non-metalled roads at the beginning of the twentieth century.[1] In 1926-27, the corresponding figures were 59,000 and 140,000 respectively,[2] and

[1] V. Anstey, *The Economic Development of India*, p. 129.

[2] *Report of the Indian Road Development Committee*, p. 88.

A statement of data relating to certain economic facts of India

(Compiled from the Statistical Abstract for British India)

	1900-1	1911	1921	1931	1938
I. Population—					
Total (in lakhs) ..	29,44	31,52	31,89	35,28	38,88 (1941)
Rural as percentage of total	90·1	90·5	89·8	89·0	
Urban as percentage of total	9·9	9·5	10·2	11·0	
II. Agriculture—					
Total area by survey (in lakhs of acres) ..	54,90	61,86	62,12	66,93	52,06
Net area sown with crop (in lakhs of acres) ..	19,70	21,60	21,23	22,91	20,94
III. Transport—					
Total route mileage open for traffic ..	24,752	32,839	37,029	42,281	41,134
Roads (in miles)—					
Metalled ..	..	..	..	74,048	63,706
Unmetalled ..	..	..	..	179,089	220,485
IV. Industry—					
Number of large establishments ..	..	..	7,514	8,404	11,460
Daily average of persons employed ..	..	..	1,559,944	1,596,417	2,034,558
V. Joint-stock companies—					
Number	..	2,465	5,189	7,713	11,114
Paid-up capital (in lakhs of Rs) ..	..	69,38	2,30,55	2,59,20	2,90,39

VI. Foreign Trade (in lakhs of Rs)—					
Imports:					
Private merchandise	76,28	1,38,57	2,66,35	1,26,37	1,52,33
Govt. stores ..	4,62	5,48	16,25	4,27	3,19
Treasure (private and Govt.) ..	24,58	53,47	31,30	7,27	3,24
Exports:					
Private merchandise	1,07,37	2,27,85	2,45,44	1,60,55	1,69,22
Govt. stores ..	35	14	3,21	65	62
Treasure (private and Govt.) ..	14,23	10,37	19,07	65,93	15,20
VII. Currency (in lakhs of Rs)—					
Notes in circulation on 31st March ..	28,88	61,36	1,74,76	1,78,14	2,07,23
Rupees coined ..	..	2,45	1,27	49	..
VIII. Banks (in lakhs of Rs)—					
Capital and Reserves:					
Reserve Bank ..	..	..	..	..	10,00
Imperial Bank ..	..	..	9,77	10,77	11,48
Presidency Banks ..	5,60	7,00	..	..	..
Joint-stock Banks ..	1,28	4,12	12,40	12,08	13,14
Deposits:					
Reserve Bank ..	..	..	..	..	24,20
Imperial Bank ..	..	..	72,58	72,18	81,51
Presidency Banks ..	15,69	38,58	..	..	..
Joint-stock Banks ..	8,08	25,29	76,90	62,26	98,08
IX. Average rupee-sterling exchange	16*d.*	$16\frac{11}{32}$*d.*	$24\frac{5}{8}$*d.* (1920) $16\frac{5}{8}$*d.* (1921)	$18\frac{1}{4}$*d.*	$18\frac{3}{32}$*d.*

by 1936, 82,000 and 224,000 respectively. The postal and telegraph systems were also reasonably adequate by the end of the last century. Unfortunately this progress in communications and transport did not synchronize with any commensurate development in commerce and industry. The end of the nineteenth century, however, witnessed a set-back rather than a development in the industrial field. This was a direct result of the impact of imported manufactured commodities facilitated by the revolution in the means of transport and communications. A very important indigenous industry of the time to be most adversely affected by imported goods was the textiles. Ranade, for instance, wrote in 1890 [1]: 'India fifty years ago clothed herself with her own manufactures and now she is clothed by her distant masters. The same is the case with wool, silk and other textiles, with oils and hides'. This decay of indigenous industries and stagnation in industrial activity during the close of the nineteenth and the beginning of the twentieth centuries is also recognized by that competent authority on Indian economic history, Dr Anstey. She writes,[2] 'In India there was a much more definite hiatus than in the West between the decay of the handicrafts and the establishment of factories, during which certain types of demand were largely met by imports'. It was not until the inspiration provided by the *swadeshi* movement that industries began to grow under Indian auspices. And even then, actual results achieved were poor until a strong stimulus was again provided by the impact of the War of 1914–18. It is pertinent to observe in this context that a large part of the industries that developed during the present century, and in particular its early years, were under European control. 'The new developments (i.e. since 1899)', remarks

[1] *Essays on Indian Economics*, p. 178.

[2] *The Economic Development of India*, p. 207.

Dr Knowles,[1] 'of cotton and jute manufactures, engineering, railway-building, and coal-mining were started by Englishmen, Scotchmen or Parsees. The Parsees had, speaking comparatively, but an insignificant share in this development.' The decay of indigenous industries towards the latter part of the nineteenth century served to further emphasize the predominantly agricultural trait of the country.

The total foreign trade of India in 1900-01 on private merchandise account was Rs1,83,65 lakhs, of which exports accounted for Rs1,07,37 lakhs, and imports Rs76,28 lakhs. These figures more than trebled during the post-war period 1919-20 to 1923-24; the post-war quinquennial average of total foreign trade on private merchandise account was Rs5,56,03 lakhs. In recent years, this figure has dwindled to something less than twice that of 1900-01.[2] An important fact about India's foreign trade is that even today,—and this was true to a still larger extent in 1900,—the bulk of this trade is handled by foreigners. No estimates of the internal trade of India are available, but there can be no doubt that it must be many times the dimension of her foreign trade. An enumeration of the significant facts bearing on Indian economics would be incomplete unless what are known as the Home Charges,[3] or

[1] *The Economic Development of the British Overseas Empire*, Vol. I, p. 440.

[2] In comparing these figures of foreign trade for different periods, allowance should be made for price variations. Thus between 1899 and 1914, prices increased by about 30%. The average price-level during the period 1919-20 to 1923-24 was over 80% higher than in 1914. The price-level began to decline after 1920-21, and in 1935-36 was about 10% lower than in 1914.

[3] These payments include the interest in the management of debt, and annuities on account of railways and irrigation works; payments due in connexion with civil departments in India; India Office expenses (including pensions); Army and Marine charges (pensions and gratuities); payments for stores purchased in India; and furlough allowances.

the commitments of the Government of India in London are mentioned. They amounted to about £20 millions before the War, and were, prior to the recent redemption of sterling debts, about £35 millions. Their influence on the Indian currency question is well known to every student of the subject.

Evolution of Financial Institutions

Against the background of this economic picture of India, a few observations on the evolution of her financial institutions may be made. The peculiar character of India's financial organization, especially towards the end of the nineteenth, and at the beginning of the twentieth, centuries, is largely a product of the superimposition of foreign interests on the Indian soil. This situation has also often resulted in open conflict of British and Indian view-points. If, in the first place, it is true that each country has a psychology of its own, to which its institutions including financial ones should be suited,[1] it has to be admitted that Indian currency and finance have been fashioned, particularly in the past, more by the interests of the British Government and of European commercial and financial institutions than by those of Indians themselves. As late as 1896, a writer in *Capital*,[2] while condemning 'the practice which is gaining ground among powerful organizations in England of attempting to interfere, on one pretext or another, with any line of policy, however well considered, adopted in the interests of India', added with refreshing candour that 'where the interests of India are seen to clash with those of England taken as a whole, India must naturally give way'. A natural corollary of this attitude, in the second place, is that no initiative was taken by the Government to encourage or promote Indian banking,

[1] *Report of the Royal Commission on Banking and Currency in Canada*, para 7.

[2] *Capital*, January, 1896, p. 4.

industry and commerce. Without this active encouragement, it was impossible for either to develop. India was mainly an agricultural country, and the financial needs of the agriculturist were being met by private money-lenders such as shroffs, mahajans, etc. Such indigenous industries as existed were neither highly developed, nor widespread, and were further either destroyed or crippled by foreign competition. There were, therefore, lacking in the indigenous economic structure, largely owing to India's politically subservient position, those powerful influences which lead to the establishment of modern financial institutions. The decline of indigenous industries, however, synchronized with growing imports of manufactured goods and the establishment of modern and large-scale industries in India chiefly under British auspices. It was but natural that these developments should coincide with the growth of appropriate financial institutions. Both European Exchange banks and Indian joint-stock banks, controlled mostly by Europeans, took root on the Indian soil. The dichotomy of the Indian money market, in the third place, particularly in the early years of this century, into European and Indian sections is largely a result of the grafting of this non-indigenous element on to the Indian body economic. What is implied is that Indian economic development has not proceeded along or been fashioned by a natural process of growth. Subsequent difficulties and anomalies, both in economic and financial spheres, are partly a reflection of demands for adjustment which the growing development of Indian industry and commerce has entailed.

Government Preoccupation with Currency and Exchange Problems

To the backwardness of Indians in industrial and commercial spheres must be added another important factor

which has retarded the progress of banking on modern lines in India. It is the excessive preoccupation with exchange and currency problems to the exclusion of those connected with banking development on the part of the Government of India, who, until the establishment of the Reserve Bank of India and more particularly in the earlier part of our period, were the chief bankers of the country. In fact, the problem of exchanges even overshadowed that of the currency requirements of the country. A perusal of the currency controversies of the late nineteenth and early twentieth centuries, as well as of the labours of the Currency Committees up to the Hilton-Young Commission of 1926, bears clear testimony to the fact that the question of the stabilization of exchanges received much greater attention than that of providing an elastic currency for the country. The demands of Indian commercial interests for the provision of an automatic currency, which would relieve the seasonal stringency in the money market with its deleterious consequences on both producers and traders, exerted much less influence on the authorities than considerations of the exchanges. There were two main reasons. In the first place, the problem of the payment of the Home Charges in London led to an emphasis on the importance of stable exchanges, and even to a preference for a high rupee-sterling exchange rate,[1] so as to relieve the Government of any uncertainty in regard to their commitments in London, with likely unfavourable repercussions on

[1] The higher the rupee-sterling exchange rate, the lower in terms of rupees is the cost of the service of these debt charges. cf. one of the main arguments of the Babington Smith Committee in favour of a 2*s*. rate that it will save the Government of India 12½ crores of rupees annually in respect of the payment of Home Charges only. For disadvantages of a high exchange rate, see s. IV of the Minute of Dissent written by Sir P. Thakurdas to the *Hilton-Young Commission Report*.

their budgetary position. In the second place, the considerations of the interests of foreign trade and the activities of the Exchange Banks invested the question of stable exchanges with great importance. It may here be mentioned that the Exchange Banks used to exercise a great and often an undue influence in the counsels of the Secretary of State for India in London.[1] To cite but one glaring instance, they agitated and succeeded in influencing the Secretary of State for India to refuse permission to the Presidency Banks to have access to the London money market even under conditions so stringent as would not have entailed any unfair competition with the Exchange Banks, and even though the proposal was strongly supported by the Government of India [2] as a measure designed to relieve the Indian money market of excessive stringency.

The excessive preoccupation of the Indian authorities with currency and exchange to the exclusion of banking problems was also commented upon in the evidence tendered in London before the Hilton-Young Commission by Mr Benjamin Strong, Governor of the Federal Reserve Bank of New York, and other American experts. Dr M. W. Sprague drew a comparison between American and Indian experiences, which were in many respects similar, and said, in reference to American experience, that it was not till 1907 that 'we were driven to perceive that defects in our banking system were present and were in that particular the seat of the troubles, and a bit of analysis showed that those defects had been similarly present in 1893 and 1873, and indeed on earlier occasions, but it had not been

[1] An interesting account of some of the activities of the Exchange Banks is provided in Chapter XI of the Minority Report of the *Indian Central Banking Enquiry Committee*, submitted by Mr Manu Subedar.

[2] Vide letter No. 17, dated 18th January, and letter No. 56, dated 22nd February, 1900, from the Government of India to the Secretary of State.

clearly recognized because they were complicated with conspicuous monetary difficulties'.[1] In reference to the Indian experience, he also commented that he considered it 'rather striking that these successive Commissions, up to the present one, at any rate, have given comparatively little attention to banking matters'.[2] In expressing this opinion Dr Sprague was in the main justified. For prior to the Chamberlain Commission Report, the only reference to the need of banking development is found in a note, appended by Mr E. A. Hambro to the report of the Fowler Committee of 1898. The Chamberlain Commission of 1914, was, however, aware of the importance of this problem, and a memorandum on the establishment of a State Bank for India was prepared by one of its members, Mr J. M. Keynes, in collaboration with one of his colleagues, Sir Ernest Cable. The Commission was, however, not 'in a position to make recommendations, one way or the other, on the question of a State Bank',[3] but added that 'we regard the question, whatever decision may be arrived at upon it, as one of great importance to India'.[4] The indecision of the Chamberlain Commission on the question of the necessity of laying a solid foundation for a banking superstructure[5] to grow and prosper was finally removed in 1926 by the recommendation of the Hilton-Young Commission to the effect that 'the necessity of unity of policy in the control of currency and credit for the achievement of monetary stability involves the establishment of a Central Banking System'.[6] The Commission clearly recognized that

[1] & [2] Q 15, 415: Minutes of Evidence.

[3] *Report of the Chamberlain Commission*, para 221.

[4] *Report of the Chamberlain Commission*, para 222.

[5] cf. observations of Governor Strong on the subject of banking in India generally. Q 15, 414: Minutes of Evidence, *Hilton-Young Commission.*

[6] *Report of the Hilton-Young Commission*, para 222 (ii).

it was essential 'for the development of banking generally that the foundations of the credit organization should be truly laid '.[1] Subsequent developments are well known. The Indian Central Banking Enquiry Committee was appointed in 1929, and its report was submitted in 1931. After many vicissitudes the Reserve Bank of India was finally inaugurated in 1935, a year which marks the beginning of a sound, stable and adequate banking structure, able to exercise, on the assumption, however, that politics does not obtrude upon national economic interests, a benign influence upon the economic progress of India.

The establishment of the Reserve Bank of India marks the most important milestone in the evolution of banking in India on modern lines. The history of this development may now be very briefly recapitulated. It has already been elaborately traced by competent authorities so that nothing but an enumeration of the salient facts need be attempted here.

Growth of joint-stock banking

The rise of joint-stock banking in India may conveniently be dated from 1809,[2] when the Bank of Bengal was established. There are instances of a few banks established earlier, but they were not of much importance. C. N. Cooke,[3] for example, mentions that probably the first banking institution in India on European lines was the Bank of Hindustan founded in 1770 by one of the agency houses in Calcutta. Dr Natarajan [4] claims, however, that the first banking institution of the

[1] *Report of the Hilton-Young Commission*, para 83.

[2] cf. article written by Rex entitled '1900 Banking' in *Capital* dated January 10, 1901, p. 41.

[3] Quoted by the *Indian Banking Enquiry Committee*, para 26.

[4] A study of the *Capital Market of Madras Presidency*, page 4, s. (ii).

western type was formed at Madras under the aegis of the Presidency Government and was actually working in 1683. Later, in 1791, the Carnatic Bank was founded in Madras.

At the end of the nineteenth century, there existed six Exchange Banks, three Presidency Banks, and eleven Indian joint-stock banks, most of which were sponsored by Europeans, and two of which had connexions with London. Their paid-up capital and reserve fund are shown in the table below [1]:

As on 30th June, 1899

Name	Paid-up Capital	Reserve Fund	Total
	Rs	Rs	Rs
Presidency Banks—			
Bank of Bengal ..	2,00,00,000	1,01,00,000	3,01,00,000
Bank of Madras ..	60,00,000	22,00,000	82,00,000
Bank of Bombay ..	1,00,00,000	76,00,000	1,76,00,000
			5,59,00,000
District Banks—			
Allahabad Bank, Ltd.	5,00,000	9,50,000	14,50,000
Alliance Bank of Simla Ltd. ..	10,00,000	12,50,000	22,50,000
Bank of Calcutta, Ld.	15,00,000	10,00,000	25,00,000
Bank of Upper India, Ltd.	10,00,000	5,40,000	15,40,000
Vhargava Commercial Bank, Ltd. ..	3,00,000	1,30,000	4,30,000
Kashmir Bank, Ltd.	1,00,000	32,000	1,32,000
Oudh Commercial Bank, Ltd. ..	3,00,000	1,80,000	4,00,000
Punjab Banking Co., Ltd.	1,78,750	1,75,000	3,53,750
Punjab National Bank, Ltd.	2,00,000	1,00,000	3,00,000
			93,55,750

[1] *Capital*, January 10, 1901, p. 41, article by 'Rex'.

Name	Paid-up Capital	Reserve Fund	Total
Local Banks with London connexion—			
Commercial Bank of India, Ltd. ..	Rs40,00,000	....	Rs40,00,000
Delhi and London Bank, Ltd. ..	£3,37,625	....	Rs33,76,250
			Rs73,76,250
Exchange Banks—			
Chartered Bank of India, Australia and China ..	£825,000	£525,000	Rs1,98,75,000
Comptoir National d' Escompte de Paris	fr.6,000,000	fr.640,000	Rs9,96,00,000
Deutsch Asiatische Bank	T/s 5,000,000	....	Rs1,00,00,000
Hongkong & Shanghai Banking Corpn. ..	$10,000,000	$1,000,000	Rs3,10,00,000
Mercantile Bank of India, Ltd. ..	£561,500	£30,000	Rs88,72,500
National Bank of India, Ltd. ..	£500,000	£300,000	Rs1,24,50,000
			Rs18,17,97,500

The total capital and reserve funds of the first three groups of banks amounted to a little over Rs7¼ crores, which was used almost exclusively in the financing of internal and coasting trade and industries. The total capital and reserve funds of the Exchange Banks added up to a little over Rs18 crores, of which the amount available for India was estimated by 'Rex' at Rs6 to 7 crores. This amount was also exclusively employed in financing foreign trade and importing sterling capital from London for use in short-term markets in India.

'Rex' made certain observations on these and other figures, which are highly significant as providing about the only available assessment of the adequacy of the Indian money market in 1900. There are no sources to verify the accuracy

of many of his estimates and observations, but they are reproduced in view of his intimate and authoritative knowledge of the then money market condition in India.

'Rex' estimated the deposits of the first three groups of banks roughly between Rs20 and 25 crores, and those of the Exchange Banks at something between Rs5 to 6 crores. And he concluded as follows: 'We have therefore a total working capital among joint-stock banks:

	Rs
For internal and coasting trade and industries less 33% cash reserve ..	21,00,00,000
For foreign trade..	8,00,00,000

The figures of trade being estimated as under:

Foreign trade	200,00,00,000
Coasting trade	100,00,00,000
Internal trade not less than	500,00,00,000

it cannot be said that financing facilities offered by existing joint-stock banks are excessive, even upon allowances made for the vast amount of capital employed by native bankers and money-lenders.'[1]

The progress of joint-stock banking in India since 1900 may be gauged from the table on the opposite page.

The deposits of all banks, excluding the public deposits of the Presidency Banks, increased from 31 crores in 1900 to 89 crores in 1914, and to 226 crores in 1920. It should, however, be noted that the figure for 1900 does not include the deposits of Indian joint-stock banks of B class, i.e., banks with capital and reserve between Rs1 lakh and less than Rs5 lakhs, as relevant particulars are not available. Yet the increase of the private deposit liabilities of all banks by about Rs137 crores between 1914 and 1920 even when due

[1] Rex in *Capital*, January 10, 1941.

In lakhs of rupees

	Presidency Banks or the Imperial Bank (from 1921)			Exchange Banks	Indian Joint-stock Banks A Class		Indian Joint-stock Banks B Class	
	Paid-up Capital, Reserve & Rest	Govt. or Public Deposits	Other Private Deposits	Deposits in India	Paid-up Capital & Reserves	Deposits	Paid-up Capital & Reserves	Deposits
1900	5,60	2,81	12,88	10,50	1,28	8,08	..	..
1905	6,23	3,12	22,26	17,10	1,62	11,99	..	..
1910	6,91	4,24	32,34	24,30	3,76	25,66	..	..
1913	7,48	5,89	36,48	31,04	3,64	22,59	50	1,51
1914	7,64	5,62	40,04	30,14	3,93	17,10	55	1,26
1920	7,52	9,02	78,01	74,80	10,92	71,14	81	2,33
1921	9,76	6,80	65,77	75,19	12,40	76,90	1,00	3,26
1926	10,72	6,45	73,89	71,53	10,84	59,61	1,25	3,47
1931	10,62	8,32	63,85	67,47	12,08	62,26	1,28	3,92
1934	10,97	6,72	74,27	71,39	12,67	76,77	1,49	5,11
1936	11,12	..	78,79	75,03	13,95	98,14	1,56	5,22
1940	11,64	..	96,03	85,57	14,66	1,13,98	2,44	11,04

allowance has been made for the rise in prices, is impressive, and also bears some testimony to the growth of Indian industry and commerce during this period. Since 1920 [1] deposits have fallen off, touching very low figures in 1929 and 1931 with Rs204 crores and Rs197 crores respectively and demonstrating the effects of the economic depression, but have revived since 1931 and reached in 1936 the figure of Rs257 crores. The recent expansion of deposits is largely a result of the great increase in the number of banks and their branches during the

[1] The price-level also began to decline since 1920-21. On the basis of 1914=100, it was 195 in 1920-21, 137 in 1929-30, 95 in 1931-32, and 91 in 1935-36.

last few years. In this rapid expansion of bank deposits, the constituent elements of the banking system have fared differently. 'Between 1930 and 1936, the share of the Indian joint-stock banks rose from 31·6 to 40·2 as against a fall from 36 to 30 per cent in the case of the Imperial Bank, which increased its deposits slightly, and a fall from 32·4 to 29·1 per cent in the case of Exchange Banks, which had more than repaired the contraction of 1922–30'.[1] The most remarkable growth has been in the case of Indian joint-stock banks of B class, whose deposits have increased from 126 lakhs in 1914 to 233 lakhs in 1920, and to 522 lakhs in 1936. This expansion is, however, accounted for largely by a growth in numbers than in size.

The resources of joint-stock banks are hardly, if at all, available for assisting agriculturists.[2] No estimates of the funds of the village money-lenders are available. But statistics showing the growth of the co-operative movement may be found interesting:

Working Capital of all kinds of Co-operative Societies in India including Indian States [3]

	No. of Societies in thousands	No. of Members in lakhs	Working capital in crores
Average for four years from 1906-07 to 1909-10 ..	2	1·6	·68
Average for five years from 1910-11 to 1914-15	12	5·5	5·48
Average for five years from 1915-16 to 1919-20	28	11·3	15·18

1 Muranjan: *Modern Banking in India*, p. 16.

2 *The Indian Central Banking Enquiry Committee's Report*, p. 191.

3 Statistical Statements relating to the Co-operative Movement in India.

	No. of Societies in thousands	No. of Members in lakhs	Working capital in crores
Average for five years from 1920-21 to 1924-25 ..	58	21·5	36·36
Average for five years from 1925-26 to 1929-30 ..	94	36·9	74·89
Average for five years from 1930-31 to 1934-35 ..	106	43·2	94·61
1938-39	122	53·7	106·56
1939-40	137	60·8	107·10

Indian Money Market at the beginning of the century

This brief study of banking development during the present century would be incomplete without a few observations on the characteristics of the Indian money market at the beginning of the twentieth century, and of their relative significance today. At the beginning of this century, there was, in the first place, hardly any money market, such as is generally understood by this term, outside the Presidency towns; and even in these places the money market was focussed on operations which passed through the European banks. A very large portion of trade finance was conducted outside the European banks; and, so far as foreign trade was concerned, it did not touch the Exchange Banks until imports were distributed in the interior or produce was ready for shipment. In financing internal trade and industries local moneylenders played a much more important rôle than the Presidency Banks or local banks. Today, this situation has been greatly modified by the rapid extension of joint-stock banking. Even in foreign trade the monopoly of the Exchange Banks has been challenged by Indian banks, and some excursions, although by no means formidable yet, has been made by the

latter in the realm of the former. The usefulness, such as it was, of the Presidency and joint-stock banks was, in the second place, further restricted by their sectional and exclusive character at the beginning of this century. Their operations were confined within defined areas, and, as such, were of little use in assisting trade between centres, outside Presidency towns. There was no systematic banking connexion between the mofussil of one Presidency and the principal port or the mofussil of another Presidency, with the result that local money-lenders continued to be the financial go-betweens for this business. This shortcoming has also been considerably removed today by the growth of a net-work of banks, often large banks with numerous branches, over the whole country. A third characteristic of the money market at the beginning of this century was a natural corollary of the poor development of joint-stock banking. It meant that finance was not impersonalized but was dependent on the whims of persons who distributed it. This accounted on certain occasions for an acute shortage of funds in what is known as the bazaar part of the money market, occasioned by the flight of money-lenders to their homes or other places of safety on the outbreak of plague or pestilences of a like nature. A perusal of the columns of *Capital* during this period will furnish many interesting and even amusing, instances of this phenomenon. Even the almanac was not without influence on the money-lender in making him unwilling to lend money on certain occasions. Such personal idiosyncracies governing the provision of financial assistance have been largely removed today by the growth of joint-stock banking. The water-tight division of the money market into European and Indian sections, the latter consisting of various forms of money-lenders, and the lack of any relationship between the rates operating in the two sections, was the fourth distinguishing

characteristic of the money market at the beginning of this century. This situation was further aggravated by the fact that, even in the bazaar, different rates would obtain at the same time owing to the system of the money-lenders dividing themselves into more or less non-competing groups.[1] As the floating capital of the money-lenders was not available in a co-operative form, finance provided by them was naturally exposed to the fancy and prejudice of individuals. The money market has not even today developed into an organic whole. Yet, it cannot be denied that rigours, associated with a lack of even flow of credit and simultaneous existence of varying money rates, have now been considerably lessened. The acute stringency in the money market, particularly of a seasonal character, has long been, in the fifth place, one of its most serious defects. This stringency was due to two main causes, viz., the absence of an automatic currency, which incidentally could be effectively worked only through the agency of a bank of issue, and the inability of the Presidency Banks to expand credit in times of severe stress. The Exchange Banks, again, opposed any proposal, designed to invest the Presidency Banks with powers to enable them to afford relief in such a situation. Whether it referred to power to be conferred upon the Presidency Banks to borrow in the London money market under stringent restrictions, or the maintenance of larger Government balances with them, the Exchange Banks were unrelenting in their opposition. Today, with the Reserve Bank in operation, the problem of seasonal stringency in the money market and the acute hardship this used to occasion has lost its earlier significance. Lastly, the absolute domination of the money market, such as it existed at the beginning of this century, by Europeans has subsequently

[1] cf. an article entitled 'Currency and the Money Market in India' extracted in *Capital*, dated April 28, 1898, pp. 639–41.

been challenged by Indians and to a certain extent assailed by them in recent years. Indians have even ventured to penetrate into the closely guarded preserves of the Exchange Banks. On the other hand, Exchange Banks, which in the beginning were practically wholly engaged in foreign exchange business, have in recent years been not only increasingly attracting Indian deposits but also extending their inland business.

CHAPTER II

THE CALCUTTA MONEY MARKET: SOME GENERAL CONSIDERATIONS

IN India, there are only two important money markets, viz., Calcutta and Bombay. It is in these two markets (as also in Madras), that the peculiar feature of the Indian money market is most in evidence, viz., the existence of two markets side by side, the central money market and the bazaar money market.[1] As between the Calcutta and Bombay money markets, Calcutta has been, and still continues to be, much the more important, although in recent years Bombay has been gaining considerably at the expense of Calcutta.

Predominant Position of the Calcutta Money Market

(a) *Area served by the Calcutta Money Market*

The predominant position of Calcutta in the Indian money market, particularly in the earlier years of the twentieth century, can be indicated by various facts. The extent of the area within the ambit of the service of the Bank of Bengal is one clear indication of Calcutta's pre-eminence. The following table (p. 24) provides interesting particulars.[2]

The vast area served by the Bank of Bengal is evident from this table. But another significant fact, as indicative of relative prosperity, is the figures of *per capita* deposit in the territories served by the Banks of Bengal and Bombay,—figures which may not be without bearing on the rapid

[1] *The Indian Central Banking Enquiry Committee*, Vol. IV (Discussions with foreign experts), p. 367.

[2] Statistical Tables relating to Banks in India (1916).

Name of Bank	Area served by Bank's Head Office and Branches	Total Population of the Areas 1911 Census 1,000	Total Private Deposits in Bank in 1916 Rs1,000	Deposits per hundred of population Rs
1. Bank of Bengal	Bengal, Burma, B. & O., C.P., U.P., the Punjab, Delhi, N.W.F.P. and Hyderabad State.	20,62,88	21,43,61	1·04
2. Bank of Bombay	Bombay Presidency including Sind, Berar and Indore.	3,31,36	13,67,09	4·13
3. Bank of Madras	Madras Presidency and Mysore.	5,20,23	9,60,17	1·85

industrial and commercial development of the western Presidency. It should, however, be added that the figure of the *per capita* deposit for the area served by the Bank of Bengal refers not merely to the Presidency of Bengal, but also to a territory which includes a number of other provinces. Even on due allowance being made for any weighting to the disadvantage of Bengal proper owing to this fact, the disparity in the *per capita* deposit figures of Bombay and Bengal is sufficiently wide to warrant the hypothesis of a relatively greater prosperity of the Bombay Presidency, as compared with Bengal.

(b) *Evidence in Chamberlain Commission*

The report of the Chamberlain Commission (1914) also furnishes evidence of the pre-eminent position of Calcutta as a money market. In the memorandum on a State Bank in India which Mr Keynes had prepared in collaboration with Sir E. Cable, the discussion on the possible location of the Central Board of the bank was confied to a consideration

of the relative merits of only Calcutta and Delhi.[1] The claims of Bombay were not even considered. As between Calcutta and Delhi, however, Delhi was preferred, in spite of the patent drawback that 'the Bank would be too little in touch with commercial opinion',[2] on the ground that 'Delhi safeguards, on the one hand, its (Central Board's) own impartiality, and on the other hand, the complete local independence of the Presidency Boards'.[3]

(c) *Resources of the Presidency Banks*

Another indication of the predominance of the Calcutta money market is provided by the following comparative figures of the resources of the Bank of Bengal, the Bank of Bombay and the Bank of Madras:

In lakhs of rupees

	1895				1913			
	Capital	Reserve	Govt. Deposits	Other Deposits	Capital	Reserve	Govt. Deposits	Other Deposits
Bank of Bengal ..	2,00	68	1,84	6,77	2,00	1,91	3,01	18,24
Bank of Bombay ..	1,00	51	76	3,58	1,00	1,06	2,00	10,15
Bank of Madras ..	50	16	45	2,78	75	73	86	8,05

The same comparative strength of the Calcutta money market is revealed in the statement[4] noted below, which Mr Norman Murray, one of the Managing Governors of the Imperial Bank of India, submitted to the Hilton-Young Commission.

[1] [2] & [3] Mr Keynes' *Memorandum*, Chapter III, Sec. 2.

[4] Appendix 48.

Current Accounts and Fixed Deposits as at the last week in March, 1925

	European Rs	Indian Rs	Banks Rs	Total Rs
Bengal	6,50,37,379	17,48,99,126	4,00,46,904	27,99,83,409
Bombay	1,37,65,861	9,67,70,250	2,71,23,598	13,76,59,709
Madras	3,23,92,064	6,19,82,015	90,74,912	10,34,48,991
TOTAL	11,11,95,304	33,36,51,391	7,62,45,414	52,10,92,109

An interesting revelation of this table is the comparatively less importance of Europeans in the industrial and commercial activities of the Bombay Presidency.

(d) *Foreign Trade Statistics*

The figures of the sea-borne trade handled by the ports of Calcutta and Bombay also provide some evidence of the pre-eminence of the Calcutta money market. In terms of merchandise only Calcutta has the largest trade. If, however, specie were also included, Bombay's total trade would exceed that of Calcutta.[1] In comparison with Bombay, Calcutta's importance as a port has deteriorated in recent years, particularly since the outbreak of the last War. The War of 1914–18 increased the relative importance of Bombay, as it served as a base for military operations both in Mesopotamia and East Africa.

(e) *Clearing House Figures*

Yet another indication of the pre-eminence of the Calcutta money market is provided by the figures of clearance of cheques at the Bombay and Calcutta centres. In the following table, the figures for Madras are also quoted, with a view to

[1] cf. V. Anstey: *The Trade of the Indian Ocean*, pp. 79–81.

afford some idea of its comparative importance as a money market.

In lakhs of rupees

	1913	1928	1938-39	1939-40	1940-41
Calcutta ..	3,33,02	10,88,19	9,49,35	11,49,64	10,05,65
Bombay ..	2,19,30	5,36,94	8,04,53	8,78,25	7,96,66
Madras ..	23,56	66,18	1,00,54	99,62	1,09,69

The relative importance of these three financial centres is more clearly revealed by percentage figures of cheques cleared in these centres relative to the total of the cheques cleared in India and Burma through the existing eight Clearing Houses.[1]

	1938-39	1939-40	1940-41
Calcutta . .	47·17	49·82	47·07
Bombay .. .	39·98	38·06	37·29
Madras	4·99	4·32	4·99

Comparative importance of Bombay and Calcutta Markets

In India the provinces of Bengal and Bombay are the two great industrial, commercial and financial areas. Bengal is the seat of the jute industry, which is mainly exporting. Bombay, which accounts for nearly 70 per cent of India's cotton mills, is mainly for the home market. Further, both the cities of Bombay and Calcutta possess first class ports, and, as important commercial centres, have attracted a number of subsidiary industries in and around them. A noteworthy fact about the industrial development in the two provinces is that, whereas in Calcutta with but few exceptions control is in the hands of British firms acting as managing agents, a preponderating share of the trade of Bombay is in Indian hands and the majority of the mills are under Indian management.[2]

[1] In addition to Calcutta, Bombay and Madras, Cawnpore, Delhi, Karachi, Lahore and Rangoon also have Clearing Houses.

[2] Cotton: *Handbook of Commercial Information for India*, p. 87.

Ever since the last Great War, Bombay as a financial centre has, however, been steadily growing in importance. Various factors are assisting this development, of which the more important ones may briefly be enumerated. The first is the increasing importance of the Bombay port. The fact that during the last War its use as a military base for Mesopotamia and East Africa increased its importance relative to the Calcutta port has already been mentioned. A serious disability of the Calcutta port, compared with the Bombay port, is its location about 80 miles up the river from the sea, as well as its inability to attract cargo ships at reasonable rates, as it is somewhat off the main sea-routes. Bombay is the nearest port of call for the traffic passing through the Suez Canal and hence receives the bulk of imports from European countries. It is also the most convenient port for vessels from the Cape. Further, the operations of the conference system among the shipping companies, as well as the very good port facilities available in Bombay, have further enhanced its relative importance as a port. In the second place, the development of railways opened up a vast hinterland for Bombay. The whole of northern India was brought within its influence. Owing to excellent railway connexions with the Punjab, it even attracts traffic which geographically might be expected to be exported from Karachi. The railway freight policy has also contributed to its importance as a commercial centre. In the third place, the exceptional facilities which indigenous bankers in Bombay offer to merchants there have in no small measure contributed to the growth of Bombay as a great commercial centre. In the fourth place, the fact that Bombay boasts of two important markets, in addition to its Stock Exchange, viz., markets in bullion and cotton, has greatly added to its financial importance. Calcutta, on the other

hand, has only one important market—the jute market. Even in respect of the Stock Exchange, the Bombay Stock Exchange is more important than that of Calcutta, probably in view of its relative proximity to European financial centres. This growing importance of Bombay as a financial centre, in comparison with Calcutta, is also demonstrated by the fact that the principal office of the Reserve Bank is now in Bombay. As a result of the control of all foreign exchange operations by the Reserve Bank, during the present war, and the operation of this control from the Bombay office of the Bank, the financial importance of Bombay has greatly increased. It is interesting to observe in this connexion that at the general meeting of the shareholders of the Reserve Bank held in August 1940, Mr M. R. Bharucha enquired of the reason for the greater number of meetings being held in Bombay as compared with Calcutta.[1] The Chairman, however, made no reply to this question.

Economic Significance of the area served by the Calcutta Money Market

In a broad sense, the area which the Calcutta money market serves today comprises, roughly speaking, the provinces of Bengal, Bihar, Orissa, Assam and some part of lower U.P. From the standpoint of economic resources this region is of outstanding importance in the whole of India. It includes the most fertile plains of the lower Ganges. The principal agricultural crops of Bengal are rice and jute. Among other crops, oilseeds and tobacco are also grown principally for sale. Over 75 per cent of the population of this region, as of India as a whole, depends on agriculture for its livelihood. Tea is the

[1] Proceedings, p. 40.

principal plantation product of both Bengal and Assam. The chief mineral resources of this whole region consist of coal and iron ore in Bihar and Orissa, and petroleum in Assam. This region is also of great significance from the point of view of industrial development. Industries may be grouped under two broad headings, viz., cottage and modern factory industries. As in other parts of India, cottage industries of various description exist in this region. It was calculated on the basis of the census figures of 1911 that approximately one million persons out of a total population of 45 millions in Bengal were dependent for their sustenance, entirely or principally, on cottage industries.[1] The area is also of exceptional importance in respect of modern large-scale factory and plantation industries. As a result of their deposits of coal and iron ore, Bengal and Bihar are the centres of India's iron and steel and engineering industries. The jute industry is mainly located on the banks of the Hooghly. In recent years a number of cotton and a few sugar mills have been established in various parts of Bengal. Bihar is an important sugar-manufacturing province. There are a number of subsidiary industries in this region, particularly in and around Calcutta, including silk and flour mills, tanneries, soap, glass, pottery, and boot and shoe factories, etc. Tea plantation industries are located in Bengal and Assam. Some idea of the progress of industrial development in Bengal may be obtained from a study of the growth of joint-stock companies, public and private, in this province. Figures relating to this growth in respect of certain important industries are given in the accompanying table[2]:

[1] *Report on the Development of Cottage Industries in Bengal*, (1921).

[2] *Report on the growth of Joint-Stock Companies in Bengal.*

Paid-up capital. In lakhs of rupees

	Tea and other planting companies		Iron, steel and ship-building companies		Engineering companies		Jute mills		Cotton mills		Sugar mills		Chemical and allied trades	
	No. of companies	Aggregate paid-up capital	No. of companies	Aggregate paid-up capital	No. of companies	Aggregate paid-up capital	No. of companies	Aggregate paid-up capital	No. of companies	Aggregate paid-up capital	No. of companies	Aggregate paid-up capital	No. of companies	Aggregate paid-up capital
As at March 31														
1900-01	134	3,28	..	..	..	..	20	3,03	8	78	2	21	..	..
1920-21	356	7,10	29	2,93	40	3,19	59	13,64	27	2,08	16	42	36	67
1930-31	479	12,37	59	3,40	75	3,50	95	19,89	55	4,21	19	85	99	1,89
1935-36	460	12,36	69	3,67	92	4,41	104	19,85	74	3,80	62	1,80	120	1,27

A relative idea of the progress achieved by Bengal can however be obtained only in reference to relevant All-India figures and the development recorded in other provinces.[1] The relative position of Bengal and Bombay compared to All-India figures is indicated in the following tables:

Number of companies at work on 31st March

	1 All-India	2 Bengal	3 Bombay	4 Percentage of 2 to 1	5 Percentage of 3 to 1
1920-21 ..	4,708	2,148	872	45·6	18·5
1925-26 ..	5,305	2,451	804	46·2	15·1
1930-31 ..	7,328	3,835	1,051	52·3	14·2
1933-34 ..	9,434	4,680	1,182	49·6	12·5

Total paid-up capital of all companies at work on 31st March

In lakhs of rupees

	1 All-India	2 Bengal	3 Bombay	4 Percentage of 2 to 1	5 Percentage of 3 to 1
1920-21 ..	1,64,46	72,90	58,83	44·3	35·7
1925-26 ..	2,76,96	1,06,46	1,02,07	38·5	36·8
1930-31 ..	2,82,68	1,11,59	97,74	39·5	34·5
1933-34 ..	3,00,80	1,33,20	96,52	44·2	32·1

These tables demonstrate that Bengal has forged ahead of Bombay in respect of both the number of companies working and their total paid-up capital. As against this advance should be set off the weakness of Bengal, compared with Bombay, in respect of average capital per company. The following table reveals not only the comparative weakness of Bengal, but also another unfavourable development, namely the tendency for the average paid-up capital of each company to progressively decrease since 1925-26:

[1] *Report on the growth of joint-stock companies in Bengal* (published in 1939 by the Department of Industries, Bengal).

Average paid-up capital of a company

In lakhs of rupees

		All-India	Bengal	Bombay
1920-21	..	3·5	3·3	6·7
1925-26	..	5·2	4·3	12·6
1930-31	..	3·7	3·0	11·3
1933-34	..	3·2	2·8	8·2

In the context of this record of the development of joint-stock companies in Bengal, the following figures of the growth of banking and loan companies in this province will be found interesting:

Joint-stock companies at work on 31st March

			No. of companies	Paid-up capital in lakhs of rupees
1920-21	Banking	..	116	1,73
	Loan	..	92	17
1925-26	Banking	..	200	6,00
	Loan	..	189	39
1930-31	Banking	..	437	6,43
	Loan	..	571	85
1934-35	Banking	..	473	3,55
	Loan	..	572	56
1935-36	Banking	..	476	3,65
	Loan	..	567	60

These figures reveal that the average paid-up capital per company has considerably decreased since 1925-26. In that year, for banking companies the average paid-up capital per company was Rs3 lakhs. In 1935-36 the corresponding figure was less than Rs77,000. To obtain a complete picture of the development of banking and loan companies in Bengal, account should also be taken of the following private companies:

Private companies at work on 31st March

			No. of companies	Paid-up capital in lakhs of rupees
1920-21	Banking	..	3	..
	Loan	..	3	2
1925-26	Banking	..	10	2
	Loan	.	9	5
1930-31	Banking	..	23	7
	Loan	..	13	6
1934-35	Banking	..	32	8
	Loan	..	15	6

In so far as the activities of the Calcutta money market is concerned, it takes little, if any, part in financing agriculture, or the requirements of cottage industries. It confines its activities mainly to financing trade, foreign, coastal and internal, and providing to some extent the short-term needs of industrial establishments. It also caters for the short-term financial requirements of the Government. Some idea of the magnitude of the financial needs the Calcutta money market seeks to supply may be had from the following figures:—

Total Foreign trade of Bengal	..	Rs105 crores.[1]
Total Coasting trade of Bengal	..	Rs 26 crores.[1]
Total Internal trade of Bengal	..	Rs 50 crores.

It should be noted that no reliable statistics are available about the internal trade of Bengal. But it has been computed roughly at the figure, quoted above, by experts. The Bengal Banking Enquiry Committee, which submitted its report in 1930, estimated the whole of the internal trade of the province at about Rs46 crores. No estimate of the requirements of industrial establishments is available. It has also to be added that references have so far been made to the financial requirements of the trade and industry of Bengal only. The Calcutta

[1] For the year 1940.

money market, it should be remembered, serves an area wider than that confined within the boundaries of the Presidency of Bengal.

The Calcutta money market, whose scope has been roughly indicated, has often been referred to, as if it were an organic whole. This, however, does not quite conform to facts. It is customary to make a broad division of the money market in India into two parts, the European or Central part, consisting of the Imperial Bank of India and the Exchange Banks, and the Indian or bazaar part, composed of money-lenders, indigenous bankers, etc., with Indian joint-stock and co-operative banks occupying an intermediate position. The classification of the Indian joint-stock banks into an intermediate category by themselves appears now to be unnecessary. The difference between the activities of the Exchange Banks and the Indian joint-stock banks is gradually wearing down. The foreign Exchange Banks attract nowadays not only growing Indian deposits, but are also increasingly engaging in inland business. Indian joint-stock banks again are penetrating into the foreign-exchange business. There is further inter-relation between Indian joint-stock banks and foreign exchange banks through the borrowing and lending of inter-bank call money. In this study, therefore, the money market will be treated as consisting principally of two broad divisions, (1) organized, composed mainly of the Reserve Bank, the Imperial Bank, Exchange Banks and Indian joint-stock banks, and (2) bazaar, mainly composed of indigenous bankers and money-lenders.

How all these institutions of the money market are organized, how they function, and what relations obtain between the various constituents of the market are problems to which we shall now address ourselves.

CHAPTER III

INSTITUTIONS OF THE ORGANIZED MONEY MARKET

THE RESERVE BANK OF INDIA

IT is not necessary for our purpose to give a detailed account of the agitation which led to the emergence of the Reserve Bank of India in 1935. The important landmarks in the story are: (1) the recommendation of the Hilton-Young Commission emphasizing the need for a unified policy in the control of currency and credit of the country; (2) the introduction to the Indian Legislative Assembly in January 1927 of a Bill 'to establish a gold standard currency for British India and constitute a Reserve Bank of India', which was abandoned owing to fundamental disagreement between the Assembly and the Government; (3) the unanimous recommendation of the Indian Central Banking Enquiry Committee (1931) that it considered it 'to be a matter of supreme importance from the point of view of the development of banking facilities in India, and of her economic development generally, that a Central or Reserve Bank should be created at the earliest possible date';[1] and (4) the provision in the new constitution, as outlined in the 'White Paper', published in 1933, that a Reserve Bank, free from political influence, should be established and be operating before the first Federal Ministry was constituted. An Act constituting the Reserve Bank of India was passed in 1934, and it started functioning from 1935. It should be observed that the Reserve Bank of India, like many other Central Banks, including the Federal Reserve System, is the creature of a

[1] Para 605.

Statute, and, as such, differs from the Bank of England, which is a product of slow evolutionary growth. In contrast to the system in India and many other countries, there are no legal restrictions imposed upon the Bank of England in relation to its banking work. In his evidence before the Macmillan Committee, Sir Ernest Harvey, Deputy-Governor of the Bank, stated that 'the restrictions, so far as there are restrictions, under which the Bank works in its operations, are restrictions which the Bank has imposed upon itself, and which of course it has the power to alter'.[1] In India, on the other hand, all the duties and responsibilities of the Reserve Bank are detailed in the Act, which set it up.

Central Banking Functions

The Reserve Bank of India was constituted with a definite purpose, that purpose being the discharge of the functions appropriate to a Central Bank. A description of these functions was lucidly given by Sir Ernest Harvey in his evidence before the Macmillan Committee. They are also set forth in the preamble to the Reserve Bank of India Act. The preamble says that 'it is expedient to constitute a Reserve Bank for India to regulate the issue of Bank notes and the keeping of reserves with a view to secure monetary stability in British India and generally to operate the currency and credit system of the country to its advantage'. The utter inadequacy of the previous financial system was patent, a system, in which currency and credit were controlled by two separate authorities and there was no one institution regulating the financial policy from the view-point of the economic development of the nation as a whole. The Reserve Bank was constituted to remove these defects and to better minister to the currency and credit requirements of the economic life of the country.

[1] Q 71.

As a Central Bank, the Reserve Bank has a three-fold purpose.[1] It is a note-issuing bank, it is the bankers' bank, and it is the banker to the State. All these responsibilities have by statute been entrusted to the Reserve Bank. It has the sole right of note issue. It is the sole banker to the Government. It is the custodian of the nation's reserve and the lender of the last resort. But there are also corresponding limitations upon its activities, directly following from its rôle as a Central Bank. It must not, in the first place, be actuated merely by considerations of profit, but must subserve the collective interests of the country. To this end, it is generally conceded that the Central Bank should as far as possible be made independent of all political control or pressure. It must, in the second place, maintain its assets in the most liquid form. For the Central Bank is the lender of last resort. It must not, in the third place, except under pressure of emergency conditions, enter into direct competition with ordinary commercial banks. For such competition would be both unfair and undesirable. It would be unfair because, as the Reserve Bank is entrusted with Government balances and also holds the statutory reserves of the scheduled banks, it could use these funds competitively to the detriment of the commercial banks. It would be undesirable because such competition would rouse the hostility of commercial banks and frustrate one important object of a Central Bank, namely that of acting as a refuge to commercial banks in distress and of controlling the credit situation generally.

Organization

Bearing in mind the purpose for which the Reserve Bank was constituted, we may now proceed to examine its actual organization.

[1] Truptil: *British Banks and the London Money Market*, p. 27.

Share Capital

The Reserve Bank is a shareholders' bank. In spite of considerable political pressure, exercised in favour of making it a state institution,—the 1927 Reserve Bank Bill was abandoned largely owing to this agitation,—the Bank has been constituted as a shareholders' bank. Notwithstanding the anomalies of the present political situation in India, this is a wise decision inasmuch as it is desirable that a Central Bank should not be made amenable to the influence of political or sectional parties in the legislature.

The original share capital of the Bank is Rs5 crores, divided into shares of Rs100 each, fully paid up. There is no bar to shareholding, except by foreigners or foreign companies, or by any citizen of, or company established in, His Majesty's Dominions which in any way discriminate against Indian subjects. The Act lays down that the Governor-General in Council shall by notification in the Gazette of India specify the parts of His Majesty's Dominions which shall have been deemed to have discriminated against Indian subjects.

With a view presumably to securing a more or less even distribution of shares all over the country, it was provided that separate registers of shareholders are to be maintained at Bombay, Calcutta, Delhi, Madras and Rangoon, and the original share capital was assigned to the various registers as follows:—

Bombay ..	Rs140 lakhs
Calcutta ..	Rs145 ,,
Delhi ..	Rs115 ,,
Madras ..	Rs 70 ,,
Rangoon	Rs 30 ,,

It was further provided, presumably with a view to prevent concentration of shares in a few hands and consequent

domination of the banks by them, that each shareholder should be entitled to one vote for every five shares held, subject to a maximum of ten votes. As, however, shares can be transferred from one register to another, the original purpose of securing an even distribution of shareholding throughout the country with a view to preventing any possible tilting of its activities in favour of a particular portion of the country, has been considerably frustrated. This will be evident on a comparison of the original assignment of shares to the different registers with their present distribution as revealed in the following figures [1]:—

Distribution of shares (in lakhs of rupees)

	Original	Dec. 31, 1938	Dec. 31, 1939	June 30, 1941
Bombay ..	1,40	2,06	2,07	2,13
Calcutta ..	1,45	1,23	1,21	1,22
Delhi ..	1,15	93	93	87
Madras ..	70	60	60	60
Rangoon ..	30	18	19	19

It will be seen that the number of shares held at the Bombay register has been increasing at the expense of other registers, particularly Calcutta and Delhi. It is also pertinent to observe that the total number of shareholders since the inception of the Bank has, at the end of 1939, declined by nearly 38 per cent, as the following figures show [2]:

[1] Reserve Bank of India: *Report on Currency and Finance*, 1940-41, p. 35 and Reserve Bank of India: *Annual Report* for the year ended June 30, 1941.

[2] Reserve Bank of India: *Report on Currency and Finance*, 1939-40, p. 35 and *Annual Report of the Reserve Bank* for the year ended June 30, 1941.

Number of Shareholders

	Original (April 1, 1935)	Dec. 31, 1935	Dec. 31, 1939	June 30, 1941
Bombay ..	28,000	20,765	19,945	19,072
Calcutta ..	23,890	13,801	13,187	12,246
Delhi ..	23,000	14,900	14,193	12,813
Madras ..	14,000	8,708	8,377	7,973
Rangoon .	3,157	1,603	1,490	1,364
TOTAL ..	92,047	59,777	57,192	53,468

With a view, however, to restrict the tendency of the Bank's shares to become concentrated in fewer hands, the Reserve Bank Act was amended in March, 1940. Under the amendment, no person can be registered as a shareholder in respect of any additional share acquired after March 26, 1940, by him, whether in his own name or jointly with another person or persons, so as to bring the total to more than Rs20,000. No shareholder is also entitled to any dividend on any such additional share held by him nor can he exercise any rights in respect of such shares except for the purpose of selling them.[1] In spite of this amendment, the tendency of the shares to be concentrated in fewer hands still continues.

The Act provides that the share capital of the Bank may be increased or reduced on the recommendation of the Central Board, with the previous sanction of the Governor-General in Council and with the approval of the Central Legislature, to such extent and in such manner as may be determined by the Bank in general meeting.

Offices and branches

The Act provides that the Reserve Bank shall establish offices in Bombay, Calcutta, Delhi, Madras and Rangoon, and

[1] See *Report of the Annual General Meeting*, Reserve Bank of India, August, 1940.

a branch in London, and may establish branches or agencies in any other place in India, with the previous sanction of the Governor-General in Council. The Bank has already established offices in places mentioned above, as well as a branch in London, and has in other places, where the Imperial Bank of India has branches, appointed the Imperial Bank as its agents. The Bank has, however, branches of its Banking Department at Cawnpore, Karachi and Lahore. The banking functions of the Lahore office have been enlarged from October 1940. It now opens principal accounts for scheduled banks, and has also taken over the management of the local clearing house.

Management

The management of the Bank is entrusted to a Central Board of Directors 'which may exercise all powers and do all acts and things which may be exercised or done by the Bank and are not by the Act expressly directed or required to be done by the Bank in general meeting'.

The Central Board consists of 16 Directors, viz.:

(i) a Governor and two Deputy Governors appointed by the Governor-General in Council after consideration of the recommendations made in that behalf by the Board;

(ii) four Directors to be nominated by the Governor-General in Council. The reason for this nominated element is explained in the following extract from the London Committee's report:

'In view . . . of the fact that in the particular circumstances of India election may fail to secure the representation of some important elements in the economic life of the country, such as agricultural interests, we recommend that a minority

of the Board should be nominated . . . , it being understood that this power would be exercised to redress any such deficiencies.' [1]

(iii) eight Directors to be elected on behalf of shareholders of the various registers on the basis of two Directors each for the Bombay, Calcutta and Delhi registers, and one Director each for the Madras and Rangoon registers;

(iv) one government official to be nominated by the Governor-General in Council.

The Governor and Deputy Governors are whole-time salaried Directors of the Bank. They hold office for a term not exceeding five years and are eligible for reappointment. The Government official Director holds office during the pleasure of the Governor-General in Council. A Deputy Governor and the nominated Government official Director may attend any meeting of the Central Board, and take part in its deliberations, but are not entitled to vote. In the absence of the Governor, a Deputy Governor may vote, if authorized in writing by the Governor. Other Directors, whether elected or nominated hold office for five years.

No Director and no member of a Local Board, whose composition is described below, can be a member of any legislature, Central or Provincial, unless within two months of his appointment, nomination or election, he ceases to be such member. No salaried government official, or salaried official of an Indian State, or officer or employee of any bank, or Director of any bank other than a co-operative bank is entitled to be a Director or a member of a Local Board. An elected or nominated Director, or any member of a Local Board,

[1] Quoted by Findlay Shirras in an article in the *Economic Journal*, June, 1934.

shall cease to hold office if, at any time after six months from the date of his nomination or election, he is not registered as a holder of unencumbered shares of the Bank of a nominal value of not less than Rs5,000, or if he ceases to hold unencumbered shares of that value, and any such Director shall cease to hold office, if without leave from the Governor-General in Council he absents himself from three consecutive meetings of the Central Board. The Governor shall convene meetings of the Central Board at least six times in each year and at least once in each quarter.

Composition and function of Local Boards

A Local Board, constituted for each of the five areas for which share-registers have been opened, shall consist of:—

(i) five members elected from amongst themselves by the shareholders, who are registered on the register for that area and are qualified to vote and

(ii) not more than three members nominated by the Central Board from amongst shareholders registered on the register for that area with a view to secure the representation of territorial or economic interests not already represented, and in particular the representation of agricultural interests and the interests of co-operative banks.

A Local Board has mainly two functions. In the first place, the elected members of the Local Board shall elect from amongst themselves one or two persons, as the case may be, to be Directors of the bank representing the shareholders of the particular area. In the second place, the Local Board shall advise the Central Board on such matters as may be generally or specifically referred to it, and shall perform such duties as the Board may, by regulations, delegate to it.

The powers vested in the Local Boards are too limited. Having once been brought into existence, the Local Boards ought to have been made more useful and allowed some measure of autonomy within their territorial jurisdiction, so as to be able to better minister to any particular needs of the areas over which they exercise authority, subject, of course, to the supervision and control of the Central Board.

Relation between Central and Local Boards

This enumeration of the functions of the Local Boards reveals their complete subservience to the Central Board. Although there are many offices and branches of the Reserve Bank of India, the resemblance to the Federal Reserve System in America is only superficial. In America the Board of Governors of the Federal Reserve System no doubt exercises great powers of control and supervision over the individual Reserve Banks. It is in fact the co-ordinating body. But the twelve Federal Reserve Banks are in most of their operations autonomous units.[1] Discount rates are fixed by the several Federal Reserve Banks, subject, however, to the review and determination of the Board of Governors. No comparable powers are enjoyed by the Local Boards of the Reserve Bank of India. They are not concerned with so many independent banks, linked together by a Central Board comparable to the Board of Governors of the Federal Reserve System, but only with local offices of the one Reserve Bank of India. A practical illustration of this difference is to be found in the fact that there is only one bank rate throughout India, whereas under the Federal Reserve System different discount rates may co-exist at the same time in different Federal Reserve regions.

[1] Burgess: *The Reserve Banks and the Money Market*, p. 210.

Business the Bank may transact

The Act lays down specifically the business which the Reserve Bank may transact and the business which it may not. The principal items of business that it may transact are:

(i) accepting of deposits without interest. This provision is intended to prevent competition with commercial banks;

(ii) the purchase, sale and rediscount of bills of exchange and promissory notes, drawn on and payable in India, and arising out of *bona fide* commercial or trade transactions, bearing two or more good signatures, one of which shall be that of a scheduled bank and having a currency of not more than ninety days. This provision would enable the Bank to discount rupee import bills, when such instruments come into being.

If such bills or promissory notes are drawn or issued for the purpose of financing seasonal agricultural operations or the marketing of crops, they may have a currency of nine months, and of the two or more good signatures they must bear, one must be that of a scheduled bank or of a provincial co-operative bank;

(iii) the purchase, sale and rediscount of bills of exchange (including treasury bills) drawn in or on any place in the United Kingdom and maturing within ninety days, but only through the intermediary of a scheduled bank;

(iv) the purchase and sale of sterling from and to scheduled banks;

(v) the making of loans and advances to States in India, local authorities, scheduled banks, and provincial co-operative banks, repayable on demand or on

the expiry of fixed periods, not exceeding ninety days, against stocks, funds and securities (other than immoveable property), in which a trustee is authorized to invest; gold or silver or documents of title to these bills of exchange and promissory notes as are eligible for purchase or rediscount by the Bank; promissory notes of any scheduled bank or a provincial co-operative bank, supported by documents of title to goods and *bona fide* commercial, trade or agricultural transactions;

(vi) the making of advances for a period not exceeding three months to the Governor-General in Council and such Local Governments as have the custody and management of their own provincial revenues;

(vii) the purchase and sale of Government securities of the United Kingdom with a maturity within ten years from the date of purchase, and of the Government of India and of a Local Government of any maturity or of a local authority in British India or of such Indian States, as the Governor-General in Council on the recommendation of the Central Board may specify; and

(viii) the borrowing of money up to an amount not exceeding the share capital of the Bank and for a period not exceeding one month, and the giving of security for such borrowed funds. No money can be borrowed from any person other than a scheduled bank, and only from a bank abroad, which is the principal currency authority of the country. The Bank has also been invested, under certain conditions, with powers to discount or make loans and advances against paper for a

period up to ninety days directly in the open market, i.e., without the signature of a scheduled or a provincial co-operative bank.

Business the Bank may not transact

The Bank is statutorily prohibited from:

(i) engaging in trade or otherwise having a direct interest in any commercial, industrial or other undertaking;

(ii) purchasing its own shares or the shares of any other bank or of any company, or granting loans upon the security of any such shares;

(iii) advancing money on mortgage or otherwise on the security of immoveable property or becoming the owner of immoveable property except such as is necessary for its own business premises and residences for its officers and servants;

(iv) making unsecured loans and advances;

(v) drawing or accepting bills payable otherwise than on demand; and

(vi) allowing interest on deposits or current accounts.

In addition to business which the Bank may or may not transact, there is a statutory obligation upon it to buy and sell sterling at its offices for immediate delivery in London at a rate not higher than 1*s.* $6\frac{3}{16}$*d.* per rupee and not below 1*s.* $5\frac{49}{64}$*d.* per rupee respectively. Tenders for the sale of sterling submitted to the Reserve Bank shall be in multiples of £1,000, subject to a minimum of £7,500 equivalent to Re1 lakh. Offers for intermediate sterling shall be in multiples of £1,000 and for amounts of not less than £25,000 in case of Bombay and Calcutta, and £10,000 in case of Delhi, Rangoon, Madras and Karachi.

Distribution of Profits

As with most Central Banks, profits are shared between the Government, the Reserve Fund and the shareholders. With practically all Central Banks,—again a notable exception is the Bank of England,—dividends on shares are regulated by law and maintained at a conservative level with a view primarily to remove the incentive to large profits. In India the Act provides for a cumulative dividend out of net annual profits at such rate not exceeding five per cent per annum on the share capital as the Governor-General in Council may fix at the time of the issue of shares. Further, a portion of the surplus shall be allocated to the payment of an additional dividend to shareholders calculated on the scale set forth in Schedule IV, which however does not start operating until the surplus on the basis of the present capital exceeds four crores of rupees. The balance of the surplus shall be paid to the Government. It is stipulated, however, that if at any time the Reserve Fund is less than the share capital, not less than fifty lakhs of rupees of the surplus, or the whole of the surplus if less than that amount shall be allocated to the Reserve Fund. It will be seen that the procedure adopted in respect of distribution of profits is on the lines obtaining under the Federal Reserve System and with the South African Reserve Bank. The amount of dividend that was decided upon at the time of the issue of shares is 3½% inclusive of income-tax.

Some other features of the Reserve Bank

Among other features of the Reserve Bank of India that deserve mention, apart from its separation into Issue and Banking Departments, which will be dealt with in connexion with the examination of the Bank's Weekly Return, are the

establishment of an Agricultural Credit Department, the agreement between the Reserve Bank and the Imperial Bank, and the obligation on the part of scheduled banks to maintain cash reserves with the Reserve Bank and submit weekly returns to the Governor-General in Council as well as to the Bank.

Agricultural Credit Department

It was a statutory obligation of the Reserve Bank to create a special Agricultural Credit Department, the functions of which should be:

(i) to maintain an expert staff to study all questions of agricultural credit and be available for consultation by the Governor-General in Council, Local Governments, provincial co-operative banks, and other banking organizations, and

(ii) to co-ordinate the operations of the Bank in connexion with agricultural credit and its relations with provincial co-operative banks or organizations engaged in the business of agricultural credit.

The purpose of creating a special department for agricultural credit may be presumed from the obligation imposed upon the Bank under S. 55(1) of the Act to submit a report to the Governor-General within three years from the date of its establishment on, along with another matter, 'the improvement of the machinery for dealing with agricultural finance and methods for effecting a closer connexion between agricultural enterprise and the operations of the bank'. It is not necessary to emphasize either the importance or the desirability of linking up rural credit with the money market. It is a problem on which no two opinions exist in the country. But it is also a problem which again by common consent admits of no easy or immediate solution. In the statutory report which the

Reserve Bank was enjoined to submit, and which it did in 1936, it was stated in paragraph 36 that 'we must also make it clear that unless the co-operative banks can put their long-term debts on a business footing and separate them from other business, the Reserve Bank will not be in a position to be of assistance to them'. Nor will the Reserve Bank be in a position to assist rural money-lenders unless their business is strictly regulated by the Local Governments and, further, paper accepted by them come through scheduled banks. However disappointing these conclusions may be, it cannot be gainsaid that there is no alternative remedy open to the Reserve Bank consistent with its proper functioning.

Agreement between the Reserve Bank and the Imperial Bank

This agreement, which is for a period of fifteen years, is set out in the Third Schedule to the Reserve Bank of India Act. Under the agreement the Imperial Bank has been constituted as the sole agent of the Reserve Bank at all places where there is a branch of the Imperial Bank in existence at the commencement of the Reserve Bank of India Act, and where there is no branch of the Banking Department of the Reserve Bank of India.

In consideration of this service the Reserve Bank has to pay the Imperial Bank for the first ten years a commission at the rate of one-sixteenth of one per cent on the first Rs250 crores, and one-thirty-second of one per cent on the remainder of the total of the receipts and disbursements dealt with annually on account of Government by the Imperial Bank on behalf of the Reserve Bank. At the end of ten years these payments to the Imperial Bank will be revised and for the next five years will be determined on the basis of the annual cost to the

Imperial Bank, as ascertained by expert accounting investigation, for performing these functions. This arrangement will be revised every five years so long as the Agreement remains in force. In addition to this, and in consideration of the Imperial Bank having no fewer branches than those existing at the commencement of the Act, the Reserve Bank has to pay to the Imperial Bank annually for the first five years of the fifteen-year period Rs9 lakhs, Rs6 lakhs for the next five years, and Rs4 lakhs for the next five. The Imperial Bank, however, cannot, without the approval of the Reserve Bank, open any branch in substitution of a branch existing at the time the Act came into force.

Statutory Deposits of the Scheduled Banks

A bank having a paid-up capital and reserves of an aggregate value of not less than five lakhs of rupees is entitled to be included in the Second Schedule to the Reserve Bank of India Act. With a view to facilitate the exercise by the Reserve Bank of control over credit, all scheduled banks are required to maintain with it a balance, which shall not at the close of business on any day be less than five per cent of the demand liabilities and two per cent of the time liabilities of such banks. The penalty for non-compliance with this requirement is the payment in respect of each day on which the balance held at the Reserve Bank is below the prescribed minimum of a penal interest at a rate three per cent above the bank rate on the amount by which the balance falls short of the prescribed minimum, and if on the day fixed for the next return such balance is still below the prescribed minimum, the rates of penal interest to be charged thereafter per day shall be increased to a rate five per cent above the bank rate.

By the Reserve Bank of India (Third Amendment) Act 1940, this penalty has been made even more rigorous. In pursuance of this amendment, when a penal rate of five per cent above the bank rate has become payable, and if thereafter on the day fixed for the next return, the balance is still below the prescribed minimum, every director and any managing agent, manager or secretary of the scheduled bank, who is knowingly and wilfully a party to the default, shall be punishable with fine which may extend to Rs500, and with a further fine up to Rs500 for each subsequent day on which default continues and the Reserve Bank may in addition prohibit the scheduled bank from receiving after the said day any fresh deposit. Every scheduled bank must also submit both to the Reserve Bank and the Governor-General in Council a weekly return signed by two responsible officers, showing (*a*) the amount of its demand and time liabilities respectively in India; (*b*) the total amount held in India in notes; (*c*) the amounts held in rupee coins and subsidiary coins respectively; (*d*) the amount of advances made and of bills discounted in India, and (*e*) the balance held at the Reserve Bank. The penalty of failure to submit the weekly return is a fine of Rs100 for each day during which the failure continues. The amount of the fine is to be paid to the Governor-General in Council, or to the Reserve Bank, as the case may be, or to each.

The Two Departments

On the model of the Bank of England, the Reserve Bank of India maintains its Issue Department separately from the Banking Department. This separation of the two departments is, however, not a common feature with Central Banks. The Commonwealth Bank of Australia, the Central Bank of China, the Bank of the Republic of Uruguay, and the National

Bank of Costa Rica are the only other banks where the two departments are kept separate.[1]

Issue Department

The Reserve Bank has the sole right to issue bank notes in British India. This provision bears clear indication of the change which the establishment of the Bank has brought about in the monetary system of India. Formerly the Government of India was the note-issuing authority. This power has been taken away from the Government and been vested in the Reserve Bank in order to enable it to function as a Central Bank. Prior to the sudden and very large demand for rupee coins which followed in the wake of the surrender of the French Government in June, 1940, only Reserve Bank notes with five-rupee notes as of the lowest denomination were in circulation. Since then, owing to the great shortage of rupee coins, consequent on this heavy demand for rupees largely for purposes of hoarding, the Government have issued one-rupee currency notes. In regard to the issue of currency notes by the Government, S. 22(1) of the Act provides that the Reserve Bank 'may, for a period which shall be fixed by the Governor-General in Council on the recommendation of the Central Board, issue currency notes of the Government of India, supplied to it by the Governor-General in Council and the provision of this Act applicable to bank notes shall, unless a contrary intention appears, apply to all currency notes of the Government of India issued either by the Governor-General in Council or by the Bank in like manner as if such currency notes were bank notes'.

[1] De Kock: *Central Banking*, p. 41.

The weekly statement of the Issue Department for the week ended 25th August, 1939, that is just prior to the outbreak of the War, is reproduced below:

Issue Department

		In '000 Rs
Liabilities—		
Notes held in Banking Department ..	37,88,92	
Notes in Circulation—		
In India	169,40,30	
In Burma	9,48,29	
Total notes issued ..	216,77,51	
Total liabilities	....	216,77,51
Assets—		
A. Gold Coin and Bullion:—		
(*a*) Held in India	41,54,48	
(*b*) Held outside India ..	2,86,98	
Sterling Securities .. .	59,50,11	
TOTAL A .	...	103,91,57
B. Rupee Coin	..	75,46,87
Govt. of India Paper Securities .	...	37,39,07
Internal Bills of Exchange and other Commercial Paper .. .	. .	....
		216,77,51

Ratio of Total of A to Liabilities : 47·937%.

On the liabilities side, there are two main items, viz., notes in circulation, in India and in Burma, and notes held in the Banking Department, the latter constituting the reserve of the Banking Department to meet its engagements at sight. The assets side represents the cover which is held against the notes issued. In India, the proportional method of holding reserves has been adopted instead of the fixed fiduciary system which obtains in Great Britain. The Act lays down that the assets

of the Issue Department shall consist of not less than two-fifths in gold coin, gold bullion or sterling securities, provided that the amount of gold shall not at any time be less than Rs40 crores in value; and the remaining three-fifths may be held in rupee coin, Government of India rupee securities of any maturity and such bills of exchange and promissory notes payable in India as are eligible for purchase by the Bank, provided that the rupee securities shall not exceed one-fourth of the total amount of assets or Rs50 crores, whichever is greater, or, with the previous sanction of the Governor-General in Council, such amount plus a sum of Rs10 crores. Gold is to be valued at its par value, 8·47512 grains of fine gold per rupee, rupee coin at its face value, and securities at the market value. Sterling securities may consist of balances at the credit of the Issue Department with the Bank of England, bills of exchange bearing two or more good signatures and drawn and payable in the United Kingdom and having a maturity not exceeding ninety days, and Government securities of the United Kingdom maturing within five years. Following German and American practices, and presumably with the idea of imparting elasticity to note circulation, the suspension of reserve requirements is permitted with the previous sanction of the Governor-General in Council on payment of a tax during such periods of suspension. The imposition of the tax is intended to prevent undue expansion. The periods of suspension are naturally short, not exceeding thirty days in the first instance which may be extended from time to time by periods not exceeding fifteen days. The rate of tax leviable is 'at the bank rate at the time being in force, with an addition of one per cent per annum when such holding exceeds 32½ per cent of the total amount of the assets, and of a further 1½ per cent per annum in respect of every further decrease of 2½ per cent or part of such decrease, provided that the tax shall

not in any event be payable at a rate less than six per cent per annum'.

On an examination of the statement of the Issue Department quoted above, it is found that gold coin, gold bullion and sterling securities account for about 48 per cent of the assets, which is well in excess of the statutory requirement of 40 per cent. The total amount of gold coin and bullion held is also much in excess of Rs40 crores, viz., nearly Rs44½ crores. Rupee securities held as cover against notes amount to a little over Rs37⅓ crores, which is much less than the permissible quota, viz., Rs50 crores or one-quarter of the total assets, which would amount to about Rs54 crores. With a view to ensure elasticity to the note issue, provision has been made in the Act for the issue of bank notes against assets of discounted eligible commercial paper within the 'B' group of assets, which constitutes three-fifths of the cover against total note-issue. No advantage has, however, yet been taken of this provision, and there has as yet been no discounted eligible commercial paper on the assets side of the Issue Department.

Since the outbreak of the present war, demand for currency within the country, not wholly for commercial purposes, has been very large. There has also been a large favourable balance of trade for India. Both these facts have made their impress on the weekly return as demonstrated in the larger circulation of currency notes and rupees, and in the larger holding of sterling securities on the assets side up to the time when the redemption of the dated India sterling stocks commenced. The weekly returns for the weeks ended September 29, 1939, i.e., a month after the declaration of war, June 30, 1940, and April 25, 1941, i.e.,—after the redemption of the terminable sterling loans had been practically completed, will be found interesting when compared with that for August 25, 1939.

Issue Department

In '000 Rs

Liabilities	Sept. 29, 1939	June 30, 1940	April 25, 1941
Notes Issued—			
In Banking Department ..	18,51,53	11,08,69	13,47,93
In Circulation—			
(*a*) In India ..	192,79,86	235,03,99	249,26,84
(*b*) In Burma ..	10,11,66	12,70,16	17,85,07
TOTAL LIABILITIES .	221,43,05	258,82,84	280,59,84

These statements show the progressive increase in note circulation in the country. Before the war, it was in the neighbourhood of Rs180 crores. Now it has exceeded Rs250 crores. The decline in the amount of notes held in the Banking Department is largely a reflex of the demand for withdrawal by depositors of commercial banks.

Issue Department

In '000 Rs

Assets	Sept. 29, 1939	June 30, 1940	April 25, 1941
A. Gold Coin and Bullion—			
In India ..	41,54,48	41,54,45	44,41,43
In U.K. .	2,86,98	2,86,98	....
Sterling securities .	64,50,11	1,31,50,11	108,79,95
TOTAL OF A	108,91,57	175,91,54	153,21,38
B. Rupee Coin	75,14,27	33,31,72	36,06,42
Govt of India rupee Securities	37,37,21	49,59,58	91,32,04
Internal Bills of Exchange and other Commercial Paper .	...	...	...
TOTAL ASSETS ..	221,43,05	258,82,84	280,59,84

These tables show the increase in the holding of sterling securities till in the last weekly return the effect of the redemption of India's terminable sterling debt is manifest. The appreciable decline in the holding of rupee coins bears evidence to the large demand for silver coins largely for the purpose of hoarding owing to the uncertainty created by the War. It is necessary to add that the item 'rupee coin' now includes one rupee notes to the value of Rs12 crores delivered by the Government to the Reserve Bank, and which under a Notification of the time was directed to be shown under rupee coin.

It will be seen from the return dated April 25, 1941 that rupee securities at over 91 crores are in excess, not only of Rs50 crores, but also of one-fourth of the total amount of the assets. This would have constituted a clear violation of S. 33 (3) of the Reserve Bank of India Act, were it not that to guard against this contravention of the law an Ordinance (No. III of 1941) was promulgated to the effect that 'the proviso to sub-section 3 of Section 33 of the Reserve Bank of India Act, 1934, shall be omitted'. There is, therefore, now no limit to the amount that may be held as rupee securities except that the assets in Group B shall not exceed three-fifths of the total assets.

Another noteworthy feature of the last return is the absence of any gold holding outside India. All gold is now held in India in the custody of the Reserve Bank of India. As this gold is valued at the statutory rate and as there has been a considerable appreciation in its value over this rate, there is behind this item now a substantial hidden reserve.

We shall now examine the weekly statement of the Banking Department.

Banking Department

In '000 Rs

August 25, 1939

Liabilities		*Assets*	
Capital Paid-up ..	5,00,00	Notes	
Reserve Fund .	5,00,00	(*a*) In India ..	37,84,66
Deposits—		(*b*) In Burma ..	4,26
(*a*) Government:		Rupee Coin .	8,04
(1) Central Govt.		Subsidiary Coin .	5,25
of India .	9,21,35	Bills Discounted—	
(2) Govt. of Burma	1,98,24	(*a*) Internal .	Nil
(3) Other Govt.		(*b*) External ..	Nil
accounts	3.93,28	(*c*) Govt. of India	
(*b*) Banks ..	26,98.40	Treasury Bills ..	41,94
(*c*) Others ..	69,54	Balances held abroad [1]	7,44,11
Bills payable ..	10,20	Loans and advances to	
Other liabilities ..	1,54,48	the Govt. .	61,00
		Other loan and advances	2,00
		Investments ..	6,81,56
		Other assets ..	1,13,27
TOTAL ..	54,46,09	TOTAL ..	54,46,09

Liabilities

The liabilities of the Bank are its debts, and consist of its capital, reserve, deposits, bills payable and other liabilities. The items, paid-up capital and Reserve Fund, require no further explanation. The deposits of the Bank have been grouped under three heads.

Government Deposits

There are, in the first place, Government deposits. Although there is no statutory provision, there appears to be an implicit understanding between the Government and the

[1] Includes cash and short-term securities.

Bank that the former will maintain certain minimum balances with the latter. As the bankers to the Governments, both Central and Provincial, the Reserve Bank holds their balances and also arranges for payments that have to be made by them. These balances normally increase when taxes are paid in, and dwindle when the Government have to make disbursements. If they fall very low, the Government obtain accommodation from the Bank in the shape of Ways and Means advances which figure under the heading 'Loans and advances to the Government' under the Assets side to meet their current financial requirements. As revenues pour in, these advances are liquidated. Government deposits are shown under three heads, viz., those of the Government of India, of the Government of Burma and of other Government accounts.

Bankers' Deposits

This item corresponds to the rôle of the Reserve Bank as the bankers' bank. These deposits are the balances which scheduled banks hold with the Reserve Bank. It will be remembered that there is a statutory obligation on these banks to maintain certain percentages of their time and demand liabilities with the Reserve Bank. In practice, these banks maintain with the Reserve Bank balances much in excess of these legal requirements. Such surplus balances are available to the scheduled banks either to meet demands for withdrawal of deposits or for expansion of credit.

The fluctuations in these deposits are an important index to the conditions prevailing in the money market. During the busy season, i.e., from November to May, the excess deposits of the scheduled banks with the Reserve Bank usually show a decline, but they generally increase during the slack season from June to October.

Other Deposits

These deposits include those of semi-public bodies, big utility companies, big railways, such non-scheduled banks and private individuals as may be permitted by the Reserve Bank to have an account with it.

Of the other two items on the liabilities side, 'Bills Payable' comprise mainly the various forms of bills drawn by the offices of the Bank upon each other, while 'other Liabilities' include the various amounts held in suspense, principally transactions in transit between the offices of the Bank and profits for distribution to shareholders and Government.

Assets

Notes: This item refers to notes which have not yet gone into circulation. They appear on the liabilities side of the Issue Department and simultaneously on the assets side of the Banking Department.

Rupee coin and Subsidiary coins

These items require no explanation except that in recent statements one-rupee notes are included under the heading 'rupee coin'.

Bills discounted

There has so far been no commercial paper in the Bank's portfolio. The only paper discounted till now is Government of India Treasury Bills.

Balances held abroad

They include mostly cash and short-term securities held on account of the Reserve Bank by the Bank of England. The short-term securities consist entirely of United Kingdom Treasury Bills. Other United Kingdom securities are held under 'Investments'.

Loans and advances to the Government and other loans and advances refer to short-period accommodation offered to the Government under Ways and Means advances and the Bank's other customers respectively.

The investments in the Banking Department consist of rupee securities of the Government of India and United Kingdom securities, and include those delivered to the Bank by the Central Government in respect of its reserve fund.

The item 'other assets' includes furniture, fittings, stationery and certain items in course of collection.

The first three items on the assets side, viz., notes and rupee and subsidiary coins are the ready funds which the Bank possesses to meet positive withdrawals of deposits, i.e., deposits which do not involve mere book transfers. These funds constitute the Bank's Reserve, and their proportion to total deposits is the ratio of liquid assets to current liabilities. In respect of the statement for week ended August 25, 1939, this ratio was over 88 per cent. The uncertainty created by the War, and partly also increased business activity have led to large withdrawal of cash by the public. This fact has naturally had reaction on the ratio of the Reserve Bank's liquid assets to its deposit liabilities. Thus, for the week ended April 18, 1941, the total deposits amounted to Rs46,23,49,000 and liquid assets to Rs11,34,34,000, so that the ratio of the latter to the former is a little below 25 per cent. This fall in the ratio is occasioned by the demand of the scheduled banks for cash in order to meet the demands for withdrawal made upon them by their clients. In normal times, such alteration in the volume of deposits of the scheduled banks, which constitute by far the most important group of the commercial banks, provide an indication of the state of the money market. It is to a study of the commercial banks that we shall now address ourselves.

CHAPTER IV

INSTITUTIONS OF THE ORGANIZED MONEY MARKET

THE IMPERIAL BANK OF INDIA

Uniqueness of the Imperial Bank

OF the commercial banks the Imperial Bank of India stands in a category by itself. It functioned up to 1934 as a Central Bank of a sort. Further its vast size and resources place it in a position of uniqueness among commercial banks. Before the establishment of the Reserve Bank, when the Imperial Bank used to hold Government balances, its total deposits exceeded those of the Indian deposits of all the Exchange Banks, and often even of those of all Indian joint-stock banks of both A and B categories, that is to say banks with paid-up capital and reserve of Rs5 lakhs and over and with capital and reserve between one lakh and less than Rs5 lakhs respectively. Even after the creation of the Reserve Bank, when Government balances and certain other accounts have been transferred to it, the total deposits of the Imperial Bank are above those of the Indian deposits of all the Exchange Banks and not very much below those of all the Indian joint-stock banks. Another noteworthy fact is that the paid-up capital and reserve of the Imperial Bank was in 1937 lower than the paid-up capital and reserves of all the Indian joint-stock banks taken together by about Rs3½ crores only. The following two tables [1] of deposits of the various categories of banks, including the Reserve Bank, and of paid-up capital and reserve of the Reserve Bank, the Imperial Bank, and the Indian

[1] *Statistical Tables relating to Banks in India*, 1937.

joint-stock banks, bring out the pre-eminent position of the Imperial Bank in the Indian money market:

Deposits of Banks

In '000 Rs

		Reserve Bank	Imperial Bank	Exchange Banks [1]	Joint-stock Banks
1933	..	....	80,56,88	70,78,42	76,42,27
1934	..	....	81,00,15	71,39,97	81,88,38
1936	..	23,28,44	78,79,50	75,22,55	103,60,67
1937	..	31,19,13	81,08,07	73,21,01	108,55,39
1938	..	24,20,33	81,50,95	67,20,42	106,08,69
1940	..	65,79,00	96,03,17	85,57,47	125,02,41

Paid-up Capital and Reserve of Banks

In '000 Rs

			Reserve Bank	Imperial Bank	Joint-stock Banks
1933	..	..	....	11,11,86	13,64,23
1934	..	..	....	11,28,15	14,16,06
1936	..	..	10,00,00	11,40,53	15,42,11
1937	..	..	10,00,00	11,42,92	14,94,96
1938	..	..	10,00,00	11,47,90	15,55,60
1940	..	..	10,00,00	11,63,61	17,09,48

The Imperial Bank was not a true Central Bank

Prior to the establishment of the Reserve Bank, there did not exist, strictly speaking, a Central Bank in India. The Imperial Bank, in so far as it functioned as a Central Bank, was in the nature of a *pis aller*. It did not perform many of the essential central banking functions, and those that it did it more often than not performed only partially.[2] It was not

[1] Indian deposits only.

[2] Evidence of the Rt. Hon'ble Montagu Norman before the Hilton-Young Commission. Q 14571–83.

the note-issuing authority. The duality in control of currency and credit hampered its function as a regulator of currency and credit. It was not entitled to operate in foreign exchange business. Its main purpose was to work for profits, within, of course, the limitations imposed upon it by statute, and not necessarily by considerations of national interests. The fluctuations in its rates during the year, and the level of the rates itself, bear testimony to this. It was, however, the holder of Government balances, but not entirely. It was the agent for Governments' financial operations but in part only. It held the reserves of other banks, and acted as a bankers' bank, but only partially. For there was a considerable hostility towards it on the part of other joint-stock banks. It, however, rendered considerable assistance in the matter of providing emergency credit by means of rediscounting.

Why the Imperial Bank was not set up as the Reserve Bank

Since the Imperial Bank was discharging, with some measure of success, some of the functions of a Central Bank, the question naturally arises as to why it was not itself constituted as the Reserve Bank. The answer to this is two-fold. 1 To convert it into the Reserve Bank would, in the first place, have involved the shearing of its commercial banking functions. 2 And to do this, in the second place, would be greatly detrimental to the cause as much of banking development in the country as of assuring cheap credit facilities to traders and other borrowers. Thus, the Hilton-Young Commission observed[1] that the conversion of the Imperial Bank into a true Central Bank would involve a radical amendment of its charter, and would preclude it 'from undertaking a great many tasks which it now successfully performs as a commercial bank. The country would then lose the benefit of

[1] Para 87.

the elaborate and widespread organization which has been set up, through the length and breadth of India, to make available to the community the increased commercial banking facilities, which are so urgently needed, and to assist in fostering, among the people as a whole, the habit of banking and investment. This consideration alone negatives the idea of disturbing the present functions of the Imperial Bank'. Similar opinions were expressed by Mr Cecil H. Kisch, tendering evidence [1] before the Hilton-Young Commission, and Dr L. J. A. Trip before the Indian Banking Enquiry Committee.[2] Dr Trip opined that 'industrial finance and the development of banking facilities in this country make it absolutely necessary to keep the Imperial Bank a commercial bank'.

A certain section of Indian opinion has not approved of the proposal to set up a Central Bank independent of the Imperial Bank. It does not, of course, favour any material restriction of commercial banking functions of the Imperial Bank. But it does not acquiesce in the theory that it is absolutely necessary to separate commercial and central banking functions. In a minute of dissent to the Hilton-Young Commission Report, Sir P. Thakurdas observed that 'in the special conditions of India, I am of opinion that the ends in view . . . will be better served by developing the Imperial Bank of India into a full-fledged Central Bank'. Again, Professor Muranjan in his book on *Modern Banking in India* observes that the Hilton-Young Commission rejected the proposal to transform the Imperial Bank into a Central Bank 'in a doctrinaire manner'.

The argument which supported the constitution of the Imperial Bank into a Central Bank without materially curtailing its commercial activities based itself upon the experience of the Bank of France. The Bank of France 'not only

[1] Q 11, 133.

[2] Vol. IV, p. 457.

performs the ordinary functions of a Central Bank, but, in addition, is the largest commercial bank in France..... A great part of the business of the Bank of France is done directly with individuals and business concerns. In order to carry on its general banking business, the French Central Bank operates a nation-wide system of 660 branches and agencies'.[1] The Commonwealth Bank of Australia was in its origin more in the nature of a commercial bank, and it retained many of its commercial activities even after it was reconstituted as a Central Bank by the Commonwealth Bank Act of 1924.

(The position in France is, however, not comparable to that obtaining in India. In France history and tradition have conspired to make the banking system what it is. There is a close relationship between the Central Bank and commercial banks in France based on friendliness, and not hostility. Although French commercial banks are not required by law to maintain reserves with the Central Bank, yet they usually keep large balances on deposit and make full use of the Central Bank's facilities for discounting and collecting commercial paper. (In India, on the contrary, such friendly relationships between the Imperial Bank and other commercial banks were far from being established. There was rather considerable hostility on the part of the commercial banks towards the Imperial Bank.) In his evidence before the Hilton-Young Commission, Mr A. Bowie,[2] of the Allahabad Bank, Ltd., complained bitterly of the competition, which he considered unfair, offered by the Imperial Bank; and suggested that even in times of difficulty the Imperial Bank was of no assistance to other banks. This probably constitutes an exaggeration of the true position. For Dr O.

[1] Madden and Nadler: *The International Money Markets*, p. 306.

[2] Q 11846–8.

Jeidels suggested in course of his discussion with the members of the Indian Banking Enquiry Committee that 'commercial banking is not so much nor so immediately affected by having the Imperial Bank as Bankers' Bank'.[1] It is also known that the Imperial Bank rendered valuable assistance to the Bengal National Bank when it was in difficulty. Yet, it cannot be gainsaid that commercial banks did entertain a certain hostility towards the Imperial Bank, and this psychological factor cannot be altogether overlooked.

There is also a material difference between French and Indian economic conditions which have reactions on the money market. As Professor Muranjan observes, there are few sensitive elements in the French export trade, whereas there are many in the case of India. (The maintenance of an export surplus is a very important consideration with monetary authorities in India, with the result that it is not possible to pursue in India the goal of monetary autonomy on French lines. It is doubtful therefore whether the responsibilities that should devolve upon a Central Bank could be adequately discharged by the Imperial Bank which, within the limits of the statute, was functioning mainly for profits. And if profits were to be restricted, it is questionable whether it could go on extending banking facilities in the way it had done.)

(In recent years, it is noteworthy that Central Banks which used to conduct considerable commercial banking business have tended to curtail the scope of this business.) Thus, De Kock[2] writes that 'the Bank of France, which had for many years been an active competitor of the commercial banks in the discounting of bills and making of advances against securities, is now reported to be less active in its competition with the other banks and to have virtually

[1] Vol. IV, p. 59.

[2] *Central Banking*, pp. 328-9.

ceased competing with them for new business'. Again, the Monetary and Banking Commission of Australia reported [1] in 1937 as follows:

'The Commonwealth Bank has taken the view that its Central Bank activities are of paramount importance, and that its development as a Central Bank should go hand in hand with some limitation of its trading activities'.

It may therefore be concluded that from the points of view of banking theory, recent developments in banking practice, and the needs of the Indian situation, the constitution of a separate Reserve Bank as a Central Bank, so as to allow the Imperial Bank to continue and enlarge its beneficent activities as a commercial bank, was a move in the right direction.

The Imperial Bank up to 1934

Constitution

The Imperial Bank was formed in January 1921 by the amalgamation of the three Presidency Banks of Bengal, Bombay and Madras. It is interesting to observe that the initiative for this amalgamation came entirely from the banks and not the Government. The proximate cause of this move was the fear engendered by the reported intention of powerful banking interests in England to obtain control of certain Indian banking interests, more particularly those of certain Exchange Banks, and the threat it would constitute to the Presidency Banks. To combat this possible danger, these banks proposed amalgamation as a means to consolidating their position. The contingency feared was the projected amalgamation of the National Bank of India with the Lloyds bank.[2] Under the amalgamation scheme, which was given

[1] Quoted by De Kock: *Central Banking*, p. 328.

[2] Baster: *The Imperial Banks*, p 182.

effect to by the Imperial Bank of India Act, 1920, the paid-up capital of the bank rose from Rs3¾ crores to about Rs6 crores.

Management

The Boards of the Presidency Banks became the Local Boards of the Imperial Bank. The Central Board was constituted by the Presidents, Vice-Presidents and Secretaries of the Local Boards, the Controller of Currency, a maximum of two Managing Governors appointed by the Governor-General and a maximum of four non-official nominees of the Governor-General. Thus Government control over the business of the bank was complete. Further, the Governor-General was empowered to issue instructions to the Bank with the specific object of safe-guarding Government balances or the financial policy of the Government.

Functions

This large and effective control by the Government of the Bank was essentially an outcome of its function as the Government's bankers. It held the balances of the Government free of interest at places where it had offices, did the treasury work of the Government free of cost, managed the public debt of the Government, provided the machinery for the floatation of loans, while its London office managed the rupee debt in London, receiving a fixed remuneration for the work. Among its other banking functions may be mentioned its rôle as a bankers' bank, the management of the Clearing House, and an obligation to extend banking facilities in the country, as evidenced in the statutory responsibility to open not less than 100 branches within the first five years of its inauguration. This responsibility was duly discharged, for 102 new branches were opened by 31st March, 1926.

Certain restrictions were specifically imposed on the business the bank could transact. It was, for example, prohibited from making loans for a period longer than six months, or upon the original security of immovable property, discounting or making loans against any bill unless it carried the several responsibilities of at least two persons or firms unconnected with each other in general partnership, granting unsecured overdrafts in excess of Re1 lakh, or transacting any foreign exchange business.

The Imperial Bank was not to have control of the note issue. That continued to be the responsibility of the Government.

The Imperial Bank at Work

The Imperial Bank was 'hardly a Central Bank so much as an amalgamation of the Presidency Banks as going commercial concerns', comments Mr Baster.[1] This observation, although in a measure largely true, was much too limited an assessment of the work of the Imperial Bank. Although it had not the authority to issue notes, it held Government balances, did Treasury work and functioned to a certain extent as a bankers' bank. With a view to assist the money market in the busy season it could obtain loans from the Paper Currency Department of the Government up to a maximum of Rs12 crores at the bank rate, subject to a minimum limit of six per cent for the first Rs4 crores and seven per cent for the remaining Rs8 crores, on the security of internal bills of exchange or hundis of an equivalent amount. Commercial banks, inclusive of Exchange Banks, used to maintain, and still maintain, balances with it and approach it for accommodation against eligible securities, mostly Government paper, in times of stress. The rate which the Imperial Bank

[1] *The Imperial Banks*, p. 183.

used to charge was for all practical purposes the then bank rate in the country, although it should be noted that this rate was charged on advances against Government securities, and not commercial bills. It financed and still finances internal trade to a considerable extent by discounting hundis of approved indigenous bankers. It further financed internal trade by providing cheap remittance facilities through the Treasury in places where it had no branches. It also rendered appreciable help to banks in distress, e.g., the Tata Industrial Bank, the Bengal National Bank and some other banks in recent years. It managed the Clearing House. It provided and still provides remittance facilities between its numerous branches to other banks and the public at cheap rates varying usually between $\frac{1}{4}$ and $\frac{1}{32}$ per cent. A notable achievement to its credit is the considerable levelling down of interest rates and stabilization of the money markets. Further, as already stated, it has rendered signal service in extending banking facilities throughout the country.

Although the judgement of Mr Baster would therefore appear to be too severe, it would be wrong to assume that the Imperial Bank was essentially and fundamentally a Central Bank. Its deficiencies as a Central Bank have already been enumerated. Its most serious shortcoming, from the point of view of the money market, was its failure to prevent high interest rates at particular seasons as well as a wide fluctuation in these rates.

The Amendment Act of 1934

On the constitution of the Reserve Bank, the Government have practically withdrawn from their association with, and control over, the Imperial Bank. The bank, however, still operates under a special Act, viz., the Imperial Bank Amendment Act of 1934. This special treatment is a recognition

of its unique place in the Indian money market, as well as of its special position as the agent of the Reserve Bank in places where the latter has no branches. Although the bank ceased to be the banker to the Government, yet the Amending Act provides for the nomination by the Governor-General in Council of not more than two persons, as well as of a Government officer, on the Central Board. This officer is entitled to attend and participate in the meetings of the Board, but not to vote.

With the withdrawal of the special privileges previously enjoyed by the bank, such as the holding of Government balances and the management of public debt, etc., the special restrictions imposed on the bank's business have also been largely removed. Under the amending Act, the bank is now authorized to open branches or agencies in India or elsewhere, transact foreign exchange business, and undertake banking business of any kind, inclusive of borrowing abroad. It can now buy and sell foreign bills of exchange of a currency of nine, instead of six, months, if they relate to the financing of seasonal agricultural operations. It can make advances against goods hypothecated to it, instead of being restricted to advances only against goods in its possession or documents of title, which are deposited with it. It can further accept as security for loans and cash credits Reserve Bank shares, municipal debentures, and securities, when permitted by the Governor-General in Council, of Native States, as also debentures or fully-paid shares of limited liability companies, approved by the Central Board.

Present Position

Although no longer banker to the Government, the Imperial Bank still plays by far the most important rôle in the Indian money market. It still attracts very large deposits

on current account without payment of any interest. The withdrawal of many of the restrictions imposed upon its working prior to the establishment of the Reserve Bank should enable it to extend its credit facilities still further and participate to an increasing extent in the financing of both internal and external trade. The only serious complaint against the Imperial Bank is, in the words of the *Bombay Provincial Banking Enquiry Committee Report*, 'that the management is alien and wooden'. The large non-Indian personnel of the bank, and consequent racial discrimination on its part, were also adversely commented upon by the Indian Central Banking Enquiry Committee. Perhaps one result of this large non-Indian personnel is that the bank is a somewhat costly institution, that a number of its branches are unremunerative, and that consequently its services are comparatively expensive. The bank should make a serious effort to remove any misapprehension on the part of the Indian public and Indian institutions in this matter.

Notwithstanding the existence of the Reserve Bank, the Imperial Bank still continues to be the institution which not only the public but also banks, whether joint-stock or indigenous, approach for loans, advances and rediscounting facilities. The Bill portfolio of the Reserve Bank has, with the exception of Treasury Bills, been, since its inception, nil. The amount of its 'other loans and advances' has also been of a small dimension,—something about Rs5 or 6 lakhs. The loans and advances of, and bills purchased and discounted by, the Imperial Bank, on the other hand, add up to a considerable sum. On December 31, 1939, the total amount was in the neighbourhood of 48½ crores, and its proportion to total deposits was over 54 per cent. For the week ended April 25, 1941, loans, advances and bills added up to over Rs41 crores, and its percentage to total deposits was about 42.

The fact that the Imperial Bank is approached for accommodation by the public as much as by banks, joint-stock or indigenous, invests it with a peculiar character in the Indian money market. For it indicates that the Imperial Bank is likely to serve, to a large extent, as a buffer between the Reserve Bank and the money market. In view of the past history and the vast resources and immense prestige enjoyed by the Imperial Bank, the control and guidance of the money market in India by the Reserve Bank will have to be shared, at least for a fairly long period of time, with the Imperial Bank. It is noteworthy that, unlike any other commercial bank, the Imperial Bank, although not obliged by law, publishes a weekly statement of its affairs. And this statement ranks on a par in importance with that of the Reserve Bank for a proper understanding of the conditions in the money market.

The Imperial Bank Statement

Week ended April 18, 1941

In '000 Rs

Liabilities

Capital—		
Authorized—2,25,000 shares of Rs500 each	11,25,00	
Issued and Subscribed do do ..	11,25,00	
Called up—75,000 shares of Rs500 each fully paid ..	3,75,00	
1,50,000 shares of Rs500 each, Rs125 paid ..	1,87,50	
		5,62,50
Reserve Liability of Shareholders—Rs375 per share on 1,50,000 shares ..	5,62,50	
Reserve Fund	....	5,62,50
Fixed Deposit, Savings Bank, Current and other accounts	....	98,54,13
Loans against Securities per contra ..	....	nil
Acceptances for Constituents	....	nil
Sundries	....	79,61
TOTAL Rs	....	110,58,74

Assets

Investments—			
Govt. Securities	..	55,33,75	
Other authorized investments	..	1,10,68	
			56,44,43
Advances—			
Loans	..	8,96,64	
Cash Credits and Overdrafts ..	..	27,03,15	
Bills Discounted and Purchased	..	5,17,49	
			41,17,28
Liabilities of Constituents for acceptances per contra	..	....	nil
Dead Stock	..	....	1,81,70
Sundries	..	....	70,26
Bullion	..	....	nil
Cash—			
In hand and with Reserve Bank	..	8,66,53	
Balances with other banks ..	..	1,78,53	
			10,45,06
	Total Rs	..	110,58,74

On the liabilities side, the Imperial Bank's paid-up capital and reserve amount to Rs11 crores 25 lakhs which is 1¼ crores above the combined figure of the Reserve Bank. The total deposits amount to over Rs98 crores and 55 lakhs. During the same week, the total deposits of the Reserve Bank stood at a little over Rs46 crores 23 lakhs, inclusive of the statutory deposits of the scheduled banks, amounting to over Rs26 crores 77 lakhs. For the same week, the demand and time liabilities of all the scheduled banks amounted to Rs289 crores 54 lakhs. This sum includes the deposits of the Imperial Bank for the week at Rs98 crores 54 lakhs. Thus the Imperial Bank accounted for a little over 34 per cent of the deposits of all the scheduled banks.

Assets

On the assets side, investments at Rs56,44,43,000 consisting of Government and Trustee securities and Treasury Bills, amount to about 50 per cent of the total liabilities or 53 per cent of the total deposits.

Loans, bills, and other advances at Rs41,17,28,000 amount to about 37 per cent of the total liabilities and 42 per cent of the total deposits. For the same week, the total advances and bills of all the scheduled banks add up to Rs137,74,81,000 of which the Imperial Bank accounts for nearly 30 per cent. Of total bills discounted by all scheduled banks, the Imperial Bank alone accounts for over 75 per cent.

Cash at about Rs10,45 lakhs amounts to over nine per cent of total liabilities, and over ten per cent of total deposits, and represents about 28 per cent of the total cash of all scheduled banks. The following table summarizes the position of the Imperial Bank *vis-à-vis* all scheduled banks in respect of certain important items explained above for the week ending April 18, 1941:

In '000 Rs

	All scheduled banks inclusive of the Imperial Bank	The Imperial Bank	
	1	2	3
			Percentage of 2 to 1
Total Deposits .	289,54,05	98,54,13	about 34
Total Bills and Advances	137,74,81	41,17,28	„ 30
Bills discounted and purchased ..	6,81,82	5,17,49	„ 75
Cash	36,12,60	10,45,06	„ 28

CHAPTER V

INSTITUTIONS OF THE ORGANIZED MONEY MARKET

THE EXCHANGE BANKS

IT is a peculiar feature of the Indian money market that a small group of banks, which are foreign in origin, not only occupies an influential position in the market, but, in certain respects, ranks in importance even above the indigenous joint-stock banks. No money market in any advanced country possesses this trait. In some of the Dominions, however, British banks play an important rôle. This is most pronounced in South Africa, where the two banks which dominate the money market, viz., the Standard Bank and the National Bank, are English. Both in Australia and New Zealand, British banks exercise considerable influence in their respective money markets. Only Canada has none but native banks. A distinction has nevertheless to be drawn between British banks operating in India and in the Dominions. There is in the first place a distinction, based on racial difference, whose reactions in the case of India were brought out during the deliberations of the Indian Banking Enquiry Committee and are referred to in the two reports, viz., the Majority and Minority Reports. In the second place, the British banks in India are much more than in the Dominions engaged in the financing of foreign trade.

Why Exchange Banks

The foreign banks in India probably owe their common appellation, 'Exchange Banks', also sometimes referred to as

'Eastern Exchange Banks', to the fact that they are primarily engaged in the financing of India's foreign trade, and, as such, have largely to deal in foreign exchange business. The name has a further advantage in that it not only lays emphasis on the essential character of the business these banks undertake but also differentiates them as a group from other commercial banks, which are indigenous in character and finance primarily internal trade and the working capital of industrial establishments, although it should be noted that in recent years the Exchange Banks have also been extending their activities in this class of business.

Their position in the Money Market

Exchange Banks in India have a long record of service behind them. They rank among the earliest joint-stock banks operating in India and they have contributed not a little to the growth of joint-stock banking, as well as of the banking habit among the people of this country. Three of the important Exchange Banks, viz., Chartered, National and Mercantile, were operating even prior to 1870, and were the most important banks at the time apart from the Presidency Banks. It is also interesting to observe that of the noteworthy indigenous banks existing in 1900, only two still survive, viz., the Oudh Commercial Bank and the Punjab National Bank. The development of Indian joint-stock banks on any appreciable scale should be dated from the beginning of this century, and particularly from after the last War. This will be borne out by the following figures of Indian deposits of Exchange Banks and the deposits of Indian joint-stock banks:

		In lakhs of rupees	
	Exchange Banks	Joint-Stock Banks A. Class	Joint-Stock Banks B. Class
1870	52	14	....
1890	7,53	2,10	....
1900	10,50	8,07	....
1910	28,16	25,62	....
1919	74,36	58,99	2,28
1920	74,80	71,14	2,33
1930	68,11	63,25	4,39
1936	75,03	98,14	5,46
1937	73,21	100,26	8,29
1938	67,20	98,08	8,72
1940	85,57	113,98	11,04

The Exchange Banks have wielded great influence in the Indian money market, sometimes unfortunately to the detriment of the country's interest. Their opposition to allowing the Presidency Banks to borrow even under strict conditions in the London market, and to the idea of establishing a Central Bank for India, are instances in point. In the influence they have exercised, they have been assisted by the fact that, their head offices being in London, they were in a position to put pressure both directly and indirectly through the London market on the Secretary of State for India. Further, the requirements of the India Government for large quantities of sterling to meet the services of what are known as Home Charges invested the Exchange Banks with considerable influence. A measure of this influence is the vetoing by the Secretary of State of the proposal, strongly supported by the Government of India, to enable the Presidency Banks, under certain conditions, to have access to the London money market.

The easy access which the Exchange Banks have to the London market has a special significance for the Indian

money market. For it means that the control of the Central or Reserve Bank over them cannot be satisfactory or complete. In his evidence before the Hilton-Young Commission, Mr Nicoll, the General Manager of the National Bank of India, suggested that he saw no necessity on the part of the Exchange Banks to take 'refuge with the Central Bank in India in the same way as we would do with the discount market in London'.[1] Commenting on this position, Mr Baster observes [2]; 'If the Empire commercial banks rediscount with the Bank of England in time of trouble, the local Reserve Bank can hardly hope to retain control of the market, unless it can provide the same facilities, and, this, in view of the present subordinate position of the money markets of the Empire to London, is out of the question'. As, ever since the inception of the Reserve Bank, no occasion has arisen for its active intervention in the money market, an opportunity for testing the ability of the Reserve Bank to exercise control over the Exchange Banks has not yet presented itself.

Business of the Exchange Banks

The principal business of these banks is the financing of India's foreign trade. They receive deposits of all kinds, current, savings and fixed, purchase bills in foreign currencies, make loans against shipping and other documents and finance imports of bullion. In respect of import of bullion, it may be recalled that the gold bars of two banks, the Chartered and the National, particularly of the latter, were most popular. This business has, however, considerably declined in recent years. The Exchange Banks also finance some portion of the inland trade, mainly on account of goods in

[1] Q 14148-9.

[2] *Imperial Banks*, p. 187. Also see *The Indian Central Banking Enquiry Committee Reports*, Vol. IV (Discussion with foreign experts), p. 391.

transit prior to export or immediately subsequent to import. The Central Banking Enquiry Committee, however, observed that it could not form any estimate of the amount of their funds invested respectively in foreign and inland business.

Although it is usually claimed on behalf of the Exchange Banks that they are concerned principally in the financing of foreign trade and are not interested in inland business, it would appear, however, that they are gradually extending their activities in this latter business. The representatives of the Exchange Banks in course of their evidence before the Indian Banking Enquiry Committee admitted that they did finance internal trade but only 'to help the import and export trade direct without the provision of an intermediary'.[1] That the interest of the Exchange Banks in the internal market is not merely incidental, but substantial, will be evident from the following comment made by Lord Inchcape at the first Annual Meeting of the P.O. Bank, on the acquisition by it of the Allahabad Bank: 'Our purchase of the Allahabad Bank . . . gives us a footing in the interior of India which it would have taken years to work up'. Again, the Eastern Bank was founded in 1909 'for the purpose of transacting both exchange and local banking'. Both the Bengal and Bombay Provincial Banking Enquiry Committee Reports testify to the participation by Exchange Banks in the internal business of the country. Thus, the Bengal Committee observes [2] that apart from advances against hessian delivery orders, 'discounting of inland bills or hundis was also in vogue among the Exchange Banks in Calcutta before the present trade depression'. And the Bombay Committee says [3]: 'The Indian branches of these foreign banks do every

[1] Q 3510-11.
[2] P. 44.
[3] P. 32.

type of banking business in addition to the business of financing the import and export trade of India'.

The Exchange Banks provide finance, not only for internal trade, but also for the short-term requirements of a few big industries. Mr Langford James, Chairman of the National Bank of India, observed in one of his annual speeches that the principal industries in which the bank was interested were cotton, sugar and jute mills, and tea and rubber companies. The Exchange Banks, however, are mainly interested in business and industries controlled or managed by Europeans. It should be added that the combined funds invested by them in financing foreign trade between ports as well as between ports and inland centres are very large. One effect of this specialization of their business, with consequent draining of deposits they attract to the ports in the busy season is 'that the exporter has far better financial facilities than the cultivator'.[1]

Complaints against Exchange Banks

While it is not denied that credit facilities provided by these banks for the financing of foreign trade are adequate and cheap, the peculiar position, as well as the operations of the Exchange Banks, has been the subject of severe criticism within the country. With the purely sentimental or political objections we need not occupy ourselves, as they are not relevant to our study. It is, in this context, extremely unfortunate that the past history and conduct of the Exchange Banks have been largely responsible for the hostility towards them, based on sentimental or political grounds. From the point of view of the efficiency of the money market, what matters fundamentally, however, is the provision of cheap and abundant credit facilities, and any measure, which hampers or prejudicially affects this process, will have unfavourable

[1] Baster: *The Imperial Banks*, p. 194.

reactions on the business and commercial communities. Further, in view of the great importance of her foreign trade to India, anything which increases the cost of its financing is to be deprecated.

There are, however, certain complaints against the Exchange Banks, which deserve some critical examination. These complaints may broadly be grouped under two heads, viz., those emanating from the Indian commercial banks and those made by the Indian clientele of these banks.

The main burden of the complaint of the Indian banks is one of unfair competition. It is said that the Exchange Banks attract deposits in India at very low rates and are thus enabled to underbid the Indian banks by offering better terms to intending borrowers. The contention of the Exchange Banks that their intervention in the internal business is negligible is not tenable, for it is now generally recognized that their activities in the interior have grown and are still expanding. Even Mr MacDonald of the Imperial Bank admitted that the deposits taken by these banks were far in excess of the requirements for the finance of foreign trade. Some corroboration of this fact may be found in the statement [1] which the Exchange Banks submitted to the Central Banking Enquiry Committee in respect of their investments for the year ending December 31, 1929. This statement reveals that while bills of exchange in transit to London and elsewhere overseas represented only Rs10 crores, loans, cash credits, overdrafts and bills discounted amounted to Rs46 crores. This latter item evidently includes a very large proportion engaged in financing foreign trade, but only between ports and inland centres, and may probably be described more appropriately as inland trade. Funds for the financing of

[1] Report, p. 336.

trade between ports only cannot be required for a long period. The period in connexion with export bills will be the time taken by these bills to reach London, where they are discounted in the market. The amount required at any time would be the amount of bills outstanding then, i.e. bills which have not reached London and been discounted. It follows, therefore, that not very large funds are normally required by Exchange Banks merely for the purpose of financing trade between ports. From this fact it also follows that a large portion of the funds which Exchange Banks attract in India is evidently invested in financing inland trade and business. Again, with the outbreak of the War and consequent restriction of foreign trade, Exchange Banks have naturally had to extend still further their internal business.

The ability of the Exchange Banks to underquote indigenous banks cannot be denied. Their monopoly of foreign business, their long standing in the market, and the late entry of the Indian banks in the field, have helped this process. But the recognition of this fact does not lead to any easy solution. For proposals intended to restrict Indian deposits of Exchange Banks to the requirements of financing only the foreign trade of India are neither feasible nor desirable. This will not only involve considerable Government interference in the activities of these banks, but also impede the efficient functioning of the credit machinery. What, if any, price should be paid for obtaining national supremacy in every field of the financial organization, is a problem which entails very difficult processes of evaluation, and lies largely outside the scope of this study.

The second group of complaints consists largely of the difficulties experienced by Indians in business catered for by the Exchange Banks.

The share, in the first place, of Indians in the foreign trade of India has been the subject of acute controversy. It was

suggested by the Indian Chamber of Commerce, Calcutta, before the Indian Central Banking Enquiry Committee, that this share was less than 15 per cent of the total. With a view to controvert this figure the Exchange Banks furnished a statement [1] giving 'the percentages of India's foreign trade in terms of bills passed through the Exchange Banks during the years 1925 and 1929 respectively'. This statement revealed that the share of Indians in the country's external trade is much larger than 15 per cent, and was, further, expanding. In his Minority Report, Mr Subedar has criticized this statement on two grounds. First, percentage figures in respect of centres where Exchange Banks have branches were not sufficient in the absence of absolute figures, which the Exchange Banks refused to furnish. Secondly, the Exchange Banks' statement ignored that portion of the import trade which was handled by the non-Indian, who arranged for the documents to be made out in the name of the final buyers, who were Indians, as well as the portion of foreign trade handled without bank intervention and which was almost wholly in the hands of non-Indians. The Majority Report of the Indian Central Banking Committee expressed their inability to form any estimate of the share of Indians in the handling of the foreign trade of India, but some members expressed the opinion that it would not be more than 20 per cent of the total.

The handling by foreigners of so large a portion of India's foreign trade means a consequent loss to India of a substantial amount in the shape of commission, brokerage, and insurance paid to non-Indians. A more serious complaint is that the monopoly of foreign business by the Exchange Banks has involved the encouragement by them of foreign traders to compete with Indian merchants in regard to the movement of

[1] Appendix, III, Vol. II, pp. 858–65.

the produce to the ports or the imported goods from the ports to inland centres.

In the second place, complaints have been made against the Exchange Banks in respect of discrimination against the Indian clientele and Indian business concerns. Thus complaints have been made in respect of bank references, given to Indian businessmen by Exchange Banks, and of margins demanded by them from Indians for opening confirmed letters of credit. A margin of 10 to 15 per cent is demanded from Indian concerns, while European houses are not required to make these deposits. Again the prevalent practice of drawing import bills D.P. instead of D.A. is attributed largely to the want of satisfactory references, furnished by Exchange Banks, as well as the larger profits earned by them on loan business against trust receipts, obtained in connexion with delivery of goods under D.P. Bills. The Exchange Banks, however, deny all these allegations against them. They deny that any discrimination is made as between Indian and non-Indian clients. They aver that they have to work on the basis of information available to them, and that a serious handicap in respect of many Indian clients is their failure to produce any proper and audited balance-sheets of their business. In respect of imports drawn on D.P. terms, they say that it is a matter essentially between the exporter and the importer, and, further, that in deciding upon the terms on which the foreign exporter will transact business, he is influenced by, not only bank references, but also confidential reports submitted by his travelling agents.

Another grievance against the Exchange Banks is their unfriendly attitude towards Indian insurance companies. It was stated before the Indian Central Banking Enquiry Committee that they were literally forcing Indian exporters to insure their goods with foreign insurance companies. The

Committee pleaded for more cordial relations between them and Indian insurance companies, and it may be said that, with the rapid extension of first class Indian companies, considerable improvement has been effected in this matter, although much yet remains to be done.

Even on the assumption that, other things being equal, an Exchange Bank will not discriminate as between its Indian and non-Indian customers, there are certain facts in the Indian situation which, in respect of its actual operations, have a discriminating effect against Indians. The most important of these is the lack of any social contact between representatives of foreign banks and of Indian business houses. The unfamiliarity with Indian conditions and mode of transacting business on the part of foreign banks makes the latter naturally more cautious in handling Indian business. All this constitutes a serious handicap for the Indian businessmen, particularly of comparatively small means, and any measure for its effective removal, short of the establishment of Indian banks in this sphere of business, is difficult to suggest. It has been already stated that restrictions on the operations of the Exchange Banks are neither practicable nor desirable. Further such discrimination against them may well provoke retaliatory measures against Indians in foreign countries.

Another complaint against Exchange Banks is that they have charged unduly high rates in respect of currencies of countries, which happened not to be represented by branches of their banks in India, and, further, that they have sometimes been opposed to the entry of banks of foreign countries into India. If, and when, however, such foreign banks did succeed in establishing branches in India, the rate of exchange with their currencies moved in favour of India with the result that Indian traders were benefited.

Even when foreign banks are represented, rates charged for currencies other than sterling are often high, so that it is often found profitable to purchase such currencies through the London market rather than directly in India. For example, dollars have often cost less when purchased through London than directly in Calcutta, even when the cost of remitting funds to London has been taken into account.

Indian Banks and Exchange business

It is extremely unfortunate that Indian banks have so far practically avoided foreign exchange business. Their deficiency in this respect has not only meant loss of a large income to India, but also considerable difficulties to those engaged in foreign-trade business, and also in the way of Indians taking an increasing share in this business. In view of the great liquidity, safety and profitability of genuine foreign exchange business, the fact that Indian banks have fought shy of this business is to be deplored. The main reasons, as enumerated by the Central Banking Enquiry Committee, why Indian banks are practically non-existent in the foreign exchange business, are the competition of well-established non-Indian Exchange Banks with large capital and reserves, absence of branches of Indian banks in London and other foreign centres, which precludes them from undertaking arbitrage and direct exchange business, the small profits now realized from the business, and the full employment of the resources of Indian banks in internal business of a more profitable character. The opinion of the Committee that foreign exchange business is now not so profitable is, however, not shared by some of the Indian banks which participate, although to a very limited extent, in this business. In spite of the reasons adduced by the Committee for non-participation by Indian banks in foreign exchange business, and there is

much truth in them, the greatest handicap appears to be the unwillingness of Indian banks to enter this field, owing mainly to their ignorance of the details of this business. A little more courage and imagination, combined with the services of an expert personnel, would certainly enable them to undertake foreign exchange business to their own profit and to the great benefit of Indian businessmen.

It may be recalled that the Alliance Bank of Simla, which, however, was managed by Europeans, and the Tata Industrial Bank, had developed a large foreign exchange business. One difficulty of Indian banks engaging in this business, as was revealed by the operations of the Tata Industrial Bank, is that of obtaining sufficient import bills. A large portfolio of only export bills entails commensurate forward T.T. sales by way of cover, with the result that profits are partially curtailed.

Of the existing Indian banks the Central Bank of India, under the far-sighted leadership of the late Sir S. Pochkhanawala, has developed considerable foreign exchange business. It even established a branch office in London under the title of 'Central Exchange Bank, Ltd.', which, however, came to an inglorious end with the sad death of Sir Sorabji. There does not appear to be any solid reason for the closing down of this institution except that the inspiring leadership and guidance of Sir Sorabji was wanting.

In recent years, some of the Bengali banks have also displayed an inclination to transact foreign exchange business. This effort is as yet very small and almost negligible, but one Bengali bank has been dealing, on a small scale, with both sterling and dollar exchange business. It was ascertained on enquiry that the bank was earning good profit on this business, and further that its activities were also gradually expanding. The main reasons why Indian customers were being diverted from the Exchange Banks were given as the

larger margins asked for and higher charges levied by them, difficulty of easy access to their managers, their indifference to customers of comparatively small means, as well as better facilities and more sympathetic consideration accorded by Indian banks.

Classification of Exchange Banks

Exchange Banks in India are usually classified into two groups, viz.: (A) those which do a considerable part of their business in India, i.e., having 25 per cent or more of their deposits in India, and (B) those which are merely agencies of large banking corporations doing a major portion of their business abroad, i.e., having less than 25 per cent of their deposits in India. It is doubtful if this differentiation is quite happy. For there may be banks in the 'B' group, which are very large world-wide institutions, e.g., the Lloyds Bank or the Hongkong Shanghai Banking Corporation or the National City Bank of New York, whose Indian deposits may be less than 25 per cent of their total deposits, and yet may amount to a substantial absolute figure and exceed the Indian deposits of banks in Category 'A'. In 1937, there were six banks in Group 'A' and twelve in Group 'B'. In February 1939, the P & O Banking Corporation (founded 1920) which was previously controlled by the Chartered Bank, was purchased by the latter. Banks in Group 'A', therefore, now number five. But as they include Messrs Thos Cook & Son (Bankers), which is mainly interested in tourist business, banks in Category 'A' really amount to four. In 1940, there were five banks in Group 'A', and fifteen in Group 'B'. Of banks in Group 'B', three operate in Burma only. Some relevant statistics, relating to 'A' and 'B' groups of banks for the year 1939, are given below:

Group 'A'

Founded	Name	Head Office	£1,000 Capital and Reserves	£1,000 Deposits
1853	Chartered Bank of India, Australia and China ..	London	6,000	53,662
1909	Eastern Bank, Ltd.	London	1,500	7,500
1858	Mercantile Bank of India ..	London	2,125	18,078
1866	National Bank of India ..	London	4,200	29,166
1866	Thos Cook & Son (Bankers) ..	London	250	3,452

All these banks have branches in Calcutta. It is of interest to observe that the National Bank of India was established in 1863 in Calcutta, under the name of the Calcutta Banking Corporation, which was changed to its present name in March 1864. The Head Office of the bank was transferred to London in 1866, and the rupee capital was converted into sterling.

These banks extend their activities outside the Indian littoral also. The Chartered Bank of India, Australia and China, in spite of its name, does not operate in Australia. Local opposition has prevented it from opening any office there. It has considerable business in Indo-China, China, the Malay State and the Dutch East Indies. It has branches in Japan, the Philippines, and New York. The National Bank of India operates extensively in Africa, and has branches in Kenya, Uganda and Tanganyika. The Eastern Bank confines its activities mainly to India, but has branches in Mesopotamia. The Mercantile Bank has extensive business connexions with the Far East, particularly with the Malay State, but also with China, Dutch East Indies, Siam and Mauritius.

Group 'B' [1]

Name	Head Office	Capital and Reserves (£1,000)	Deposits (£1,000)
Lloyds Bank (which has taken over the business of King & Cox)	London	25,310	433,583
Grindlay & Co. (controlled by National and Provincial Bank)	London	350	3,744
Nederlandsche Handel-Maat-Schappij (known as Netherlands Trading Society)	Amsterdam	6,819	38,650
Nederlandsch Indische Handles-bank (known as Netherlands Indian Commercial Bank)	Amsterdam	6,055	14,498
Hongkong Shanghai Banking Corporation	Hongkong	8,359	208,127
National City Bank of New York	New York	32,218	577,759
American Express Inc	New York	1,765	6,242
Comptoir National d' Escompte de Paris	Paris	4,834	56,813
Banco Nacional Ultramarino	Lisbon	420	9,918
Yokohama Specie Bank	Yokohama	14,174	113,875
Bank of Taiwan	Taipeh (Formosa)	1,285	24,787
Mitsui Bank	Tokio	7,396	78,733

Of the twelve banks in Group 'B', only nine are represented in Calcutta. The three banks not represented are Comptoir National d'Escompte de Paris, Banco Nacional Ultramarino and the Mitsui Bank.

[1] Foreign currencies have been converted at rates quoted in the Statistical Tables relating to Banks in India and Burma, 1939 and 1940.

Deposits of Exchange Banks

The total deposits of the Exchange Banks bear no significance for the Indian market. What is of importance for our purpose is their Indian deposits, which in 1937 amounted to:

Group 'A': Rs33,68 lakhs.
Group 'B': Rs39,53 lakhs.

The total deposits in India of the Exchange Banks amounted in 1937 to nearly 73,21 lakhs. There are only a few branches of the Exchange Banks in inland towns. Further their most important branches are located in the two commercial centres of Bombay and Calcutta. No estimate of their deposits in any single centre is available. But on the assumption that Indian deposits of the Exchange Banks in Calcutta, Bombay and other centres will be approximately in the ratio of 50 : 40 : 10, the Indian deposits in Calcutta and Bombay work out roughly at Rs36,60 and Rs29,29 lakhs respectively. On the same basis, the Indian deposits of the Exchange Banks in Calcutta and Bombay work out at Rs42,78 and Rs34,23 lakhs respectively in 1940.

Investments of Exchange Banks

Although figures of Indian deposits of Exchange Banks are furnished in the Statistical Tables relating to Banks in India, no particulars are available in respect of their investments in India. This position is extremely unsatisfactory, inasmuch as no reliable estimate of their operations in the Indian money market can be made. Now that under the new Insurance Act foreign insurance companies have to publish accounts of their Indian business, there appears to be no sufficient reason why a similar obligation should not be imposed on foreign banks operating in India. It is of course not implied that they should publish their figures of Indian and non-Indian business in India. If Exchange Banks should object to publishing

separate accounts for their Indian business, a consolidated statement of their Indian investments under a few major headings may be made available in the same way as a consolidated figure of their total Indian deposits is now published. Even such a statement will be of great use to the student of the Indian money market.

Some idea of the way in which the assets of the Exchange Banks are made up can be had from the Statement[1] submitted by them for the year ended December 31, 1929 to the Indian Central Banking Enquiry Committee. Total deposits at that date amounted to Rs66 crores, and loans and overdrafts outside India Rs22 crores. These amounts were invested as follows:

Loans, cash credits, overdrafts and local bills discounted (excluding bills of exchange)	Rs46 crores
Investments in Govt. and other Indian Trustee Securities and Indian Treasury Bills	Rs26 „
Bills of exchange in transit to London and elsewhere overseas	Rs10 „

The balance of Rs6 crores would probably account for the cash balances. Mr Buckley informed the Committee that the advances were in connexion with the export and import trade. These were, therefore, all short period investments. Funds invested in the money market would therefore amount to Rs46 crores plus Rs10 crores plus such amount as were invested in Indian Treasury Bills. On an assumption of a total of Rs60 crores, short-term investments amount to nearly 68 and 90 per cent of total funds and total Indian deposits respectively.

[1] *Report*, p. 336.

CHAPTER VI

INSTITUTIONS OF THE ORGANIZED MONEY MARKET

A. INDIAN JOINT-STOCK BANKS

Provisions of the Companies Act

ALL banks registered under the Indian Companies Act come under this category. According to S. 277F of the Indian Companies (Amendment) Act, 1936, a banking company means a company which carries on as its principal business the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order, notwithstanding that it engages in addition in one or more of the other multifarious businesses enumerated in the Act. This definition has, however, given rise to certain anomalies. As the Reserve Bank points out,[1] although on December 31, 1938, approximately 1,421 companies were operating in British India which may be considered as non-scheduled banks, that is, banks not included in the Second Schedule to the Reserve Bank, only about 626 banks or 45 per cent were submitting the cash reserve returns under S. 277L of the Companies Act. One reason for this disparity was that a large number of companies claimed that they were not banks inasmuch as they did not accept deposits withdrawable by cheque. Another reason was that under the existing law companies which were registered before January 15, 1937, are allowed to call themselves banks even if they do not carry on banking business as defined in the Act. With a view to remove these anomalies, the Reserve Bank in its Memorandum on 'Proposals for an

[1] *Proposals for an Indian Bank Act*, p. 23.

Indian Bank Act'[1] has suggested that banking should be defined as 'the accepting of deposits on current account or otherwise subject to withdrawal by cheque, and, further, that no company which does not do banking business shall use the word " bank ", " banker ", or " banking " as part of its name '.

Some of the important provisions of the Indian Companies (Amendment) Act as they affect banks may be briefly mentioned. In the first place, a bank cannot employ or be managed by a managing agent other than a banking company. In the second place, a bank is prohibited from commencing business unless its paid-up capital amounts to at least Rs50,000. In the third place, a bank must set apart each year a sum not less than 20 per cent of its declared profits for appropriation to a reserve fund until it is equal to the paid-up capital, and, further, this reserve fund must be either invested in Government or Trustee securities or deposited in a special account with a scheduled bank. In the fourth place, every banking company must maintain a cash reserve equivalent to at least 1½ per cent of its time liabilities and 5 per cent of its demand liabilities, and also file with the Registrar of Joint-Stock Companies before the tenth day of every month a statement of the amount so held on the Friday of each week of the preceding month with particulars of the time and demand liabilities of each such day. This last provision, however, does not apply to a scheduled bank. And lastly, there is a penalty provided in the Act for any violation of its provisions.

Relative Importance of Joint-Stock Banks

Although mostly of a comparatively recent origin, Indian joint-stock banks form an important part of the banking

[1] Owing to the outbreak of the war, consideration of the Draft Bank Bill prepared by the Reserve Bank has been postponed.

system of the country. Their total number and resources, as well as the services they render, bear witness to the prominent rôle they play in the Indian money market. They operate today over about two-thirds of the centres with banking facilities in the country. Even as late as 1918, there were only 47 banks with a paid-up capital and reserve of Re1 lakh and over, with 197 branches, and their aggregate paid-up capital and reserves amounted to Rs6,65 lakhs, the deposits to Rs42,15 lakhs, and cash balances to Rs9,85 lakhs. In 1937, the number of these banks increased to 151 with 829 branches and offices, and their aggregate paid-up capital and reserves, deposits, and cash balances amounted to Rs14,95, Rs108,55 and Rs18,15 lakhs respectively. In 1940, the corresponding figures for 180 banks with 1,177 offices were Rs17,19, Rs125,02 and Rs28,51 lakhs respectively. Their importance *vis-à-vis* the Imperial Bank and the Exchange Banks is revealed in the table overleaf.

Rapid growth of Joint-Stock Banks

Three observations may be made on these figures. The first is the rapid expansion of the deposits of the joint-stock banks between 1918 and 1937, i.e., within barely two decades. While the deposits of the Imperial Bank and the Exchange Banks increased by about 33 and 20 per cent, those of the joint-stock banks recorded an increase of about 160 per cent. Between 1937 and 1940, the rate of increase in the deposits of these three categories of banks has been more or less of the same order; the deposits for 1940 being 16, 19 and 16 per cent over that of 1937 for the Imperial Bank, the Exchange Banks and the joint-stock banks respectively. A noteworthy fact is the decline in the Indian deposits of Exchange Banks up to 1938, since when they have recorded a fairly large increase. It is probable that this increase is accounted for mostly by a swelling

In thousands

	Capital and Reserves			Deposits			Cash Balances		
	Exchange	Imperial	Joint-Stock	Exchange[2]	Imperial	Joint-Stock	Exchange[2]	Imperial	Joint-Stock
	£	Rs	Rs	Rs	Rs	Rs	Rs	Rs	Rs
1918[1]	39,448	7,19,58	6,65,12	61,26,33	59,62,03	42,14,83	22,29,08	17,07,62	9,58,48
1928	187,923	11,01,72	12,29,37	71,13,86	79,25,30	65,35,02	8,05,57	10,58,00	8,71,09
1937	128,312	11,42,92	14,94,96	73,21,01	81,08,07	108,55,39	10,58,05	13,43,00	18,12,57
1940	128,686	11,63,61	17,19,48	85,57,47	96,03,12	125,02,41	16,53,28	24,82,81	28,50,66

[1] Figures under Imperial Bank refer to the Presidency Banks.
[2] Figures refer to Indian Deposits and Indian Cash Balances.

of the deposits of non-British Exchange Banks owing to a diversion of deposits to these banks from British and even Indian joint-stock banks consequent on the debacle of France in June 1940. As no figures are published of the Indian deposits of individual Exchange Banks, this hypothesis cannot unfortunately be corroborated. A comparative estimate of the growth of the joint-stock banks as between 1918, 1937, and 1940 is given below:

	1918[1]		1937		1940	
	Head Offices	Branches and offices	Head Offices	Branches and offices	Head Offices	Branches and offices
Imperial Bank ..	3	68	3	163	3	390
Exchange Banks	..	48	..	99	..	101
Joint-Stock Banks	47	197	151	829	180	1,177

Various factors are responsible for this rapid development of joint-stock banks, of which some are general and others of special importance to Bengal. The general factors are rapid industrial development, increased income and the growth of the habit of thrift. The depression of 1930-31 again witnessed a great fall in prices but no commensurate reduction in salaried incomes, with the result that an impetus was given to the growth of deposits. The factor of special importance to Bengal is the reaction of the great depression on the loan offices and investment in land. The fall in land values revealed the weakness of this popular form of investment in Bengal, and was also responsible for the sorry plight of the loan offices. From the insecurity of such investments the public began to turn increasingly to banks for the safe-keeping of their surplus income. This process gave a great impetus to the growth of joint-stock banks in Bengal.

[1] Figures of the Imperial Bank refer to those of the Presidency Banks.

It is, however, pertinent to point out that the increase in deposits of the joint-stock banks is largely accounted for by an increase in the number of banks and their branches, and does not imply any strengthening of the average position of the banks.

Thus in 1918 the average capital and reserve, and deposits per office, were about Rs2·7 lakhs and Rs17 lakhs respectively; and the corresponding figures for 1937 are about Rs1·5 lakhs and Rs11 lakhs respectively and for 1940 Rs1·3 and Rs9·2 lakhs respectively. When, further, it is recalled that there are a few joint-stock banks with large capital and reserves as well as deposits, it will become evident that a good number of these banks must be small and weak institutions.

The second observation refers to the position of the cash balances of the joint-stock banks. This position compared to that of the Imperial Bank and of the Exchange Banks is revealed in these figures:

Percentage of Cash to Deposit Liabilities

	1928	1937	1940
Imperial Bank	13	17	25·9
Exchange Banks	11	14 5	19·3
Joint-Stock Banks ..	14·5	16·5	22·8

This comparatively satisfactory proportion of the cash balances of the joint-stock banks should not by itself be interpreted as an indication of either their soundness or liquidity. Such an interpretation would be possible only after an examination of the structure of assets of these banks. This study will be undertaken later.

In the third place, the figures quoted so far in relation to joint-stock banks, their number, branches, deposits, etc. are not complete. They refer only to such of these banks as have a paid-up capital and reserve of at least Re1 lakh. There

are, however, numerous still smaller banks. Relevant figures in respect of all these banks are unfortunately not available. In a memorandum which the Reserve Bank submitted in connexion with its 'Proposals for an Indian Bank Act', it computed the total number of non-scheduled banks at 1421. No details regarding capital and reserves of 101 banks were available. The capital and reserves of the remaining 1,320 banks as on December 31, 1937 were Rs4,44,63,000. The capital and reserves of the Indian scheduled joint-stock banks, which numbered only thirty, amounted on the same date to Rs11,58,78,000. These figures bear, generally speaking, an eloquent testimony to the comparative strength of scheduled and non-scheduled banks. It is, further, noteworthy that the capital and reserves of the two biggest joint-stock banks only, viz., the Bank of India and the Central Bank of India, amounted in 1937 to Rs5,09,41,000.

Classification of Joint-Stock Banks

These banks have been classified in two ways,—one adopted by the Government in their publication, 'Statistical Tables relating to Banks in India', and the other followed by the Reserve Bank.

Classification in the Statistical Tables

For the purpose of the 'Statistical Tables relating to Banks in India', joint-stock banks are sub-divided into two groups according as they have a paid-up capital and reserves of (*a*) Rs5 lakhs and over, and (*b*) Re1 lakh and over and less than Rs5 lakhs. By implication, there should be a third category consisting of banks with a paid-up capital and reserves of less than Re1 lakh; but the Statistical Tables provide no

information about them[1]. Some idea of the relative importance and growth of these two categories of banks may be had from the following tables:

Class A: Banks having a paid-up capital and reserve of over Rs5 lakhs

In '000 Rs

	Number	Paid-up Capital	Reserve and Rest	Total	Deposits	Cash Balances
1920	25	8,37,02	2,55,46	10,92,48	71,14,64	16,30,70
1930	31	7,47,31	4,42,84	11,90,15	63,25,51	7,67,91
1937	39	7,25,17	5,53,09	12,78,26	100,26,50	16,81,80
1938	43	7,48,91	5,65,51	13,14,42	98,08,27	14,00,29
1940	58	9,08,95	5,56,67	14,65,62	113,98,45	26,26,19

Class B: Banks with capital and reserve of Re1 lakh and less than Rs5 lakhs

1920	33	61,42	19,95	81,37	2,33,46	41,91
1930	57	90,57	50,28	1,40,85	4,39,18	52,19
1937	108	1,44,15	72,55	2,16,70	8,28,89	1,32,78
1938	120	1,62,48	78,70	2,41,18	8,72,42	1,28,90
1940	122	1,67,42	76,44	2,43,86	11,03,96	2,24,47

These tables reveal the phenomenal growth of class 'B' banks in respect of both number and deposits. Deposits of these banks have increased between 1920 and 1937 by nearly 275 per cent while those of class 'A' banks have risen by about 40 per cent only. Yet, absolutely considered, class 'B' banks, in spite of their large superiority in number, lag far behind class 'A' banks in point of capital, reserves or deposits. The average capital and reserve, and deposit per bank of class 'A' were in 1937 about Rs30½ lakhs and Rs228 lakhs respectively.

[1] Since the Reserve Bank has taken up the publication of these Statistical Tables from 1939 two other categories, C and D, in respect of banks having paid-up capital and reserves between Rs50,000 and Re1 lakh, and less than Rs50,000 respectively have been added.

The corresponding figures for class 'B' banks were about Rs2 lakhs and Rs7¼ lakhs respectively.

Reserve Bank Classification

In the classification made by the Reserve Bank, no distinction is, however, made between Indian joint-stock banks and other banks such as the Imperial Bank and the Exchange Banks. It sub-divides all banks into two broad categories, viz., scheduled banks and non-scheduled banks. Not all scheduled banks are Indian joint-stock banks, although all non-scheduled banks fall within this category. It will be recalled that banks with a paid-up capital and reserves of at least Rs5 lakhs may be listed in the Second Schedule to the Reserve Bank Act. A reference to Table No. 10 of the Statistical Abstract for 1937 reveals that not all banks which satisfied this condition were scheduled to the Reserve Bank. No explanation for the non-inclusion of these banks can be put forth except that they did not apply for inclusion in the schedule. It may be added that the change in the interpretation of the rule governing inclusion of banks in the Second Schedule was not adopted in 1937. Only in 1940, owing to certain difficulties experienced by the Government of India in including banks in the Second Schedule, the Government decided that the words 'aggregate value of paid-up capital and reserves' occurring in the Act should be interpreted to mean the real or the exchange value of the paid-up capital and reserves, and not merely the book value as shown in the balance sheet. Such an interpretation of the rule which banks will now have to satisfy for inclusion in the Second Schedule will effectively prevent the resort to manipulation or malpractices by them for acquiring the minimum qualification to become scheduled to the Reserve Bank.[1]

[1] *Report on Currency and Finance*, 1930-40, para 67.

The tables on the opposite page show the comparative position of non-scheduled and scheduled banks as on December 30, 1938.

On the basis of banks for which figures are available, the average deposit per bank belonging to non-scheduled and scheduled categories is Rs2,46,000 and Rs4,26,06,000 respectively. One significant feature bearing on the respective position of the scheduled and non-scheduled banks is the relation between demand and time liabilities. Time liabilities are about three times the demand liabilities of non-scheduled banks, i.e., their respective proportions are a little over 75 per cent and a little less than 25 per cent of the total deposit liabilities. The corresponding figures for the scheduled banks are a little over 54 per cent and a little less than 46 per cent respectively. This very large proportion of time liabilities in the case of non-scheduled banks denote, from the standpoint of commercial banking, as much their less developed growth as their comparatively weaker position.

Indian Scheduled and Non-Scheduled Banks

It will be recalled that while all non-scheduled banks are Indian banks, registered under the Indian Companies Act, the scheduled banks include the Imperial Bank and the Exchange Banks, which are not so registered. A proper comparative study should therefore base itself upon the position of non-scheduled banks with that of Indian scheduled banks only. The figures for the latter can be obtained by deducting from the total figures for all scheduled banks those referring to the Imperial Bank and the Exchange Banks. Another difficulty in reconstructing figures for the Indian scheduled banks only under the heads 'demand and time liabilities' is that the deposit figures of the Imperial Bank and the Exchange Banks are not provided separately under these headings. In the

Non-Scheduled Banks

	Number submitting Cash-Reserve Returns	In '000 Rs				
		Total Demand Liabilities	Total Time Liabilities	Total of 2 and 3	Cash on hand and at Bank	Percentage of cash to total Deposit Liabilities
	1	2	3	4	5	6
Banks with paid-up Capital and Reserve of Rs50,000 or over	186	2,50,96	8,34,71	10,85,67	72,78	6·7
Banks with paid-up Capital and Reserve of less than Rs50,000	440	1,31,83	3,24,04	4,55,87	33,23	7·1
Total non-scheduled banks ..	626	3,82,79	11,58,75	15,41,54	1,06,01	6·8
Scheduled Banks						
	56	130,15,36	108,44,09	238,59,45	19,19,93	8·0

following table, therefore, time and demand liabilities have been lumped together:

In lakhs of rupees

	Total Number	Deposits	Cash on hand and at Bank	Percentage of Cash to total Deposit Liabilities
Non-Scheduled Banks, 1938	626	15,42	1,06	6·8
Indian Scheduled Banks,[1] 1937	36	89,78	3,77	4·2

An interesting revelation of this table is the smaller cash reserve of the Indian scheduled banks. The average deposit per bank belonging to non-scheduled and Indian scheduled categories is Rs2·5 lakhs and about Rs250 lakhs respectively.

Concentration of Resources

A noteworthy feature of the Indian scheduled banks is the very large concentration of resources in the hands of a few banks. This phenomenon, it should be underlined, is one of concentration of resources only, and not, as in Great Britain, of concentration in banking and consequently of resources also. As distinct from the development in Great Britain, there has been no large-scale process of amalgamation of banks in India. On the contrary, there has been a steady growth in the number of banks as well as in their branches. *Apropos* branch expansion, it is interesting to observe that, while in Great Britain amalgamation has led to the closing down of many inefficient and unprofitable branches, in India, on the contrary, there has been a spate of branch expansion by individual banks with the result that many centres, particularly in the moffussil, have more banking establishments than can possibly be economically and profitably maintained.

[1] Including Burmese banks.

'The Big Five'

Following the British precedent, five Indian joint-stock banks are popularly designated as the 'big Indian five'. Their resources, however, bear no comparison with those of the 'big British five'; yet the grouping in India has its advantages in demonstrating the concentration of resources in the hands of the five big banks. They are the Bank of India, the Central Bank of India, the Allahabad Bank, the Bank of Baroda and the Punjab National Bank. Of these, the Allahabad Bank is Indian in the sense that it is registered under the Indian Companies Act, but it is not Indian either in respect of management or control. For, it is affiliated to the Chartered Bank of India, Australia and China, which comes under the general category of Exchange Banks. By far the largest bulk of the resources in the money market are, however, controlled by the Bank of India and the Central Bank of India, which may be described as 'the biggest two'.

The table overleaf incorporating figures for 1937 brings out the relative importance of the big five, and the biggest two among Indian banks.

Thus the big five control about 48, 66 and 67 per cent respectively of the total paid-up capital and reserves, total deposits and total cash balances of all Indian joint-stock banks of class 'A' and class 'B'. The relative figures for the biggest two are about 34, 44, and 44 per cent respectively. If the comparison were made with only the Indian scheduled banks, the big five account for nearly 63, 77 and 76 per cent respectively of their total capital and reserves, deposits and cash balances, while the corresponding figures for the biggest two are about 44, 51, and 54 per cent respectively.

It would be interesting to compare the resources of the five big Indian with the five big Bengali banks. The five big Bengali

	Number of reporting banks	Branches	In '000 Rs			
			Paid-up Capital	Reserve	Total Deposits	Cash Balances
All class 'A' and class 'B' banks ..	152	829	8,73,48	6,27,31	108,65,99	18,12,57
Indian Scheduled Banks	31	538	6,72,80	4,93,91	93,50,70	15,47,07
The Big Five .	5	153	3,65,02	3,51,37	72,05,90	11,68,98
The Biggest Two ..	2	68	2,68,13	2,41,28	47,81,99	8,31,27

banks are the Bengal Central Bank, the Comilla Banking Corporation, the Comilla Union Bank, the Nath Bank, and the Bhowanipur Banking Corporation. The table overleaf incorporates the figures for 1937.

How very far the Bengali banks lag behind the big Indian banks has been brought out in very clear relief in the above table. In fact the combined resources of all the five Bengali banks taken together do not reach the resources controlled by any one of the big Indian five. The smallest of the big Indian five are the Bank of Baroda and the Punjab National Bank, whose relevant figures for 1937 are given below:

In '000 Rs

	Capital and Reserve	Total Deposits	Cash Balances
Bank of Baroda	60,04	6,79,58	1,07,50
Punjab National Bank ..	54,33	6,96,47	62,57

The position of the Indian biggest two, the big five, and the Bengali big five for the year 1940 is detailed below:

In '000 Rs

	Paid-up Capital	Reserve	Deposits	Cash Balances
The Indian Biggest Two..	2,68,13	2,40,52	56,77,49	14,65,37
The Indian Big Five ..	3,95,06	3,66,55	84,51,53	19,10,86
The Bengali Big Five ..	35,36	23,03	6,72,07	1,74,57[1]

It is interesting to observe that while between 1937 and 1940, deposits of the big Indian five and the biggest Indian two have increased by about 18 and 19 per cent respectively, those of the big Bengali five show an increase of over 38 per cent over the same period.

[1] Inclusive of call money.

	Branches	In '000 Rs					
		Paid-up Capital	Reserve	Total of 2 and 3	Total Deposit	Total Liabilities 4 and 5	Cash Balances
	1	2	3	4	5	6	7
The Big Indian Five ..	153	3,65,02	3,51,37	7,16,39	72,05,09	79,21,48	11,68,98
The Biggest Indian Two	68	2,68,13	2,41,28	5,09,41	47,81,99	52,91,40	8,31,27
The Big Bengali Five .	72	20,19	20,42	40,61	4,14,19	4,54,80	87,61

Structure of Assets

An examination of the assets of a banking concern provides some indication of its solvency and liquidity. No precise or final judgement on the financial position of a bank is, however, possible merely on a study of the balance-sheet figures. For by far the largest item on the assets side is loans and advances. Without a careful scrutiny of the different constituents of this item, it is not possible to venture any opinion as to whether the bank is maintaining a satisfactory liquid position and conducting its business on safe lines and in accord with commercial banking principles. The composition of the assets portfolio will also be partly influenced by the composition of the liabilities side. If time liabilities should preponderate over demand liabilities, a bank need not maintain as liquid a position as it should in the opposite case. Further, what elements will constitute the assets side, and in what proportion, depends largely on the varieties and proportion of investments available to commercial banks from time to time within the territory in which they operate. International comparisons of the structure of assets of commercial banks may be largely vitiated, if due note is not taken of this fact. It may be mentioned [1] here that the general practice among British joint-stock banks is to maintain about 10 per cent of their deposits in cash, 5 to 6 per cent in call money, 15 per cent in bills including Treasury Bills, 30 per cent in investments and about 40 per cent in advances. As against this, scheduled banks in India maintain about 13 per cent of their deposits in cash, 6 per cent in bills, 50 per cent in investments, and 40 per cent in loans and advances. The proportion of capital and reserves to deposits among British joint-stock banks is 6 per cent, while it is 13 per cent among Indian scheduled

[1] *Proposals for an Indian Bank Act*, p. 27.

banks. Within the limits of the financial and economic conditions in which commercial banks have to function, they distribute their investment portfolio in such a way as to obtain the maximum of profit consistent with maximum liquidity and elasticity of their funds.

The composition of the assets of the commercial banks of class 'A' and class 'B' respectively for 1937 was as follows:—

In lakhs of rupees

	Cash	Capital and Reserves	Deposits	Bills discounted Loans and Advances	Govt. and other Securities
Class 'A' Banks	16,82	12,78	100,27	55,07	37,61
Class 'B' Banks ..	1,31	2,23	8,39	7,62	1,04
Total for Class 'A' and Class 'B' ..	18,13	15,01	108,66	62,69	38,65

The proportion of cash, investments, and loans and advances including bills discounted to total deposits of both these classes of banks is about 16·5, 35·2 and 57·1 respectively. In regard to class 'B' banks only, the proportion to their deposits of loans and advances, and investments is 90·8 and 12·8 respectively. This bears testimony to their comparatively non-liquid position, while an extenuating feature is that a large portion of their liabilities is in the shape of fixed deposits.

An analysis of the assets of Indian joint-stock banks may also be made on the basis of the classification adopted by the Reserve Bank, although it should be borne in mind that the scheduled banks include both the Imperial Bank and the Exchange Banks. The figures for the non-scheduled banks refer to 672 banks which submitted cash reserve returns.

In '000 Rs

	Total Deposits	Cash in hand and with banks	Investments in securities and shares, in fixed deposits, etc.	Loans including bills discounted	Immovable property
Non-scheduled banks as on 30-12-1938 ..	11,97,29	1,56,58	2,30,24	10,24,97	74,74
		Percentage to total deposits			
	....	13·1	19·1	85·7	....
All scheduled banks as on 30-12-1938 ..	238,59,45	19,19,93	....	118,90,97	....
		Percentage to total deposits			
	....	8·1	....	49·8	....

The analysis (overleaf) of the assets of the Indian scheduled banks exclusive of the Imperial Bank, the Indian big five, the Indian biggest two, and the Bengali big five refer to the year 1937.

This table reveals that Bengali banks invest most of their funds in loans and advances. As much as 63·9 per cent of the deposits of the big Bengali five are invested practically in loans and advances, for very few bills are either discounted or purchased by them. Their investments amount to 28 per cent of their deposits. The big Indian five have 4·3, 42·3 and 42·8 per cent of their deposits invested in bills, investment and loans and advances respectively. The cash balance position of the big Bengali five is, however, more favourable than that of the big Indian five, being 21·5 per cent of their deposits as against 16·1 per cent for the latter. One significant feature of the structure of assets of joint-stock banks is the very small investment in bills. This, incidentally, is a commentary on the present state of the bill-market in India. As good bills are not available, a large proportion of the funds of joint-stock

In '000 Rs

	Total Deposits	Cash Balances	Bills discounted and purchased	Loans and Advances	Govt. and other Securities	Other assets
Indian scheduled banks excluding the Imperial Bank	93,50,70	15,47,07	4,10,30	47,24,43	34,84,67	8,25,37
	As percentage of total deposits					
	....	16·5	4 4	50·5	37·2	8·8
Big Indian Five ..	72,05,90	11,68,98	2,35,86	33,07,58	28,70,87	5,68,54
	As percentage of total deposits					
	....	16·1	3·1	45·9	39·8	..
Biggest Indian Two ..	47,81,99	8,31,27	2,08,13	20,36,75	20,13,81	3,15,80
	As percentage of total deposits					
	....	17·6	4·3	42·8	42·3	...
Big Bengali Five ..	4,14,19	87,61	2,65,11		1,15,68	35,86
	As percentage of total deposits					
		21·5	63·9		28·0	

banks has to be invested in safe securities,—largely giltedged, and in loans and advances, in which, again cash credits bulk heavily.

Some features of Bengali joint-stock banks

Although there are a few good Bengali banks of moderate size, banking development in this province has not been very healthy. There are far too many small banks. The Reserve Bank expresses the opinion that an examination of the balance sheets of 128 non-scheduled banks reveals an unsatisfactory position. The deposit liabilities are large in proportion to paid-up capital and reserves, the proportion of the latter to the former being 14·9 per cent. On an average, investments amount to about 22·5 per cent of deposits, loans 65·5 per cent and cash 6·8 per cent. That the assets are often unreal is borne out by the fact that 93 out of 128 banks, whose balance sheets were examined by the Reserve Bank, were working at a loss.

Even of the larger Bengali banks it may be said that their average size is still small. A craze for opening out branches is an unsatisfactory feature of banking development in Bengal. Quite often branches are opened up, not so much with an eye on the needs of the localities and on the possibilities of business to maintain them profitably, but in a competitive spirit. This is not a healthy feature; and what is needed in Bengal is more an amalgamation of existing small institutions than the establishment of new banks or branches.

The smaller Bengali banks have now to work under a disability on account of the enactment of the Bengal Money-Lenders' Act. Banks, which are not scheduled to the Reserve Bank, are not exempted from the operations of the Act, which places many restrictions on the business of

lending of money. As it was the intention of the Legislature to exclude all banks, which genuinely functioned as such and were not merely money-lending institutions, it was provided in the Act that the Government can exclude any bank from the purview of the Act by a notification in the Calcutta Gazette. Unfortunately the Government have not as yet published any set of rules, which a bank, claiming exemption from the operations of the Act, will have to satisfy. This is not a satisfactory position, and the uncertainty of the status of the smaller banks in relation to this Act is a source of considerable anxiety to them. The Government should take the earliest steps to formulate certain general principles for the guidance of the smaller banks, and remove the present uncertainty of their position.

Another fact which seriously threatened the existence of smaller banks in Calcutta was the attitude towards them of the members of the Calcutta Clearing Banks' Association. The latter refused in certain cases to accept cheques, drafts, etc. on small non-clearing banks for collection, and when they did collect such instruments, they used to levy a collection charge. The resulting situation with which the smaller Bengali banks were faced was of considerable gravity, but it has been satisfactorily dealt with by the resourcefulness displayed by the smaller banks in establishing a Clearing House of their own, called the Metropolitan Clearing House, which has received the recognition of the Calcutta Clearing Banks' Association.

A feature of comparatively recent origin is a welcome tendency on the part of Bengali banks to increase their portfolio of a type of internal bills. These bills do not satisfy all the conditions of a good bill, for generally they are not accepted bills. The banks, also, do not usually discount or purchase them, but only make advances against them up to a certain limit, which varies with the standing of the drawer

and the drawee and the nature of the bill. The bills are usually drawn for goods supplied either by manufacturers or middlemen of, generally speaking, not very large means. The reason why Bengali banks prefer such bills as a form of investment is their higher profitability consistent with safety. It should be added that dealing in such bills does not facilitate the development of a bill market inasmuch as they are not usually accepted bills.

Comparison of banking development in Bengal and Bombay

The most important distinguishing feature of banking development in Bengal and Bombay is the smaller number of banking establishments in the latter province and the very large number that exists in the former. Of the scheduled banks there were in 1937 only four in the Bombay Presidency but ten in Bengal, including the Allahabad Bank. Of the non-scheduled banks, there are in Bengal 921 banks with paid-up capital and reserves below Rs50,000 and 67 with paid-up capital and reserves over Rs50,000. The corresponding figures for Bombay are 17 and 9 only.

Of the scheduled banks in Bombay, the Bank of India and the Central Bank of India are the two biggest Indian banks. Their predominant position in the Indian money market has already been made abundantly clear. The Bengali scheduled banks bear no comparison with these two big institutions, or even with the other comparatively smaller scheduled banks in Bombay, e.g., the Union Bank of India, whose capital and reserves, and deposits in 1938 amounted to Rs51,52,000 and Rs1,06,09,000 respectively.

An examination of the relevant balance-sheets also brings out a noteworthy difference between Bengali and Bombay scheduled banks. In the first place the Bengali banks pay a

higher rate of interest on their deposits, which is indicative of either a larger proportion of time in relation to demand liabilities, or a larger rate of interest paid on time liabilities as the rate paid on demand liabilities is the same, or both. In the second place the rate of return earned on investible funds are much higher in the case of Bengali than of Bombay banks, which indicate the relatively more liquid position of the latter. The table on the opposite page incorporating figures from the balance sheets of six banks for the year ending December, 1940, will be found instructive.

The table reveals that Bengali banks pay an interest of about 2·20 per cent on their deposits, and earn a little over six per cent on their investible funds. As bank balances earn little or no interest, they along with cash have been excluded from the funds considered to have been invested. Although call money has also been similarly excluded, it earns very little interest and its exclusion does not materially affect the conclusions drawn. What is noteworthy is the exceptionally strong position of the Bank of India. It pays an interest of about one per cent on its deposits. But as the figure of total interest paid, viz., Rs23,25,000 also includes appropriation to unadjusted contingency accounts, the rate of interest paid on deposits may be lower than even one per cent. The earning rate on invested funds is also the lowest in the case of the Bank of India, being a little over two per cent. This is an unmistakable testimony to the great liquidity of its position. Of the non-scheduled banks there were 988 in Bengal in 1938. Of these 988 banks only 233 submitted cash reserve returns. Of the 26 non-scheduled banks in Bombay, 22 submitted cash reserve returns. Of these 233 and 22 banks respectively in Bengal and Bombay, which submitted cash reserve returns, balance-sheets of 128 and 13 banks respectively were received by the Reserve Bank. An analysis of the

In '000 Rs

Name of Bank	Total Deposits	Interest paid	Percentage of 3 to 2	Total Funds, i.e. Deposits, Capital and Reserve	Cash and Bank balances including Call Money	Column 5-6	Interest, commission, etc. earned	Percentage of 8 to 7
1	2	3	4	5	6	7	8	9
Bank of India .	22,27,61	23,25	1·04	24,44,11	6,14,81	18,29,30	38,42	2·10
Central Bank of India	32,49,88	39,91	1·22	35,42,03	9,02,31	26,39,72	1,15,99	4·39
Bengal Central Bank . .	1,06,56	2,31	2·17	1,10,24	34,11	76,13	4,69	6·17
Comilla Banking Corporation . .	1,50,08	3,32	2·21	1,66,71	45,83	1,20,88	7,45	6·16
Comilla Union Bank [1]	1,87,93	4,81	2·60	2,02,96	54,43	1,48,53	9,96	6·03
Nath Bank . .	1,34,94	2,96	2·18	1,45,47	33,26	1,12,21	7,18	6·39

[1] Year ending April 13, 1940.

balance sheets of these banks for the year 1938 reveal the following position:

In '000 Rs

	Paid-up Capital	Reserves	Total Capital and Reserves	Deposits	Cash in hand and with banks	Investments in securities and shares, in fixed deposits, etc	Loans including bills discounted	Immovable properties
Bengal ..	21,71	12,81	34,52	2,31,64	15,85	52,04	1,51,73	28,82
As percentage of deposits					6·8	22·5	65·5	12·4
Bombay ..	4,42	53	4,95	49,10	6,98	4,27	26,18	..
As percentage of deposits					14·2	43·3	53·3	..
Madras ..	1,20,93	37,66	1,58,59	5,30,06	53,18	89,65	5,83,95	17,38
As percentage of deposits					10·0	16·9	110·2	3·3

The figures for non-scheduled banks in the Madras Presidency have also been quoted, as it is only in Bengal and Madras that these smaller banks preponderate. The total number of these banks registered in 1938 in Madras was 252, of which balance sheets in respect of only 195 banks were received. The most striking feature of the non-scheduled banks in Madras is that their loans and advances amount to over 110 per cent of their deposits. The comparative figures for Bengal and Bombay are 65·5 and 53·3 per cent respectively. Percentages of cash and investments to total deposits are largest in Bombay, and are an indication of the comparatively better position of the non-scheduled banks in that province.

B. THE PROVINCIAL CO-OPERATIVE BANK

A brief mention should be made here of another financial institution in Calcutta, namely, the Provincial Co-operative Bank, although its influence on the Calcutta Money Market is negligible.

The Bengal Provincial Co-operative Bank was established in 1918. It represents a federation of central co-operative banks and has no individual members as shareholders. It has also admitted a certain number of primary societies as members. Its primary function is to collect the surpluses of the constituent banks as well as to make to the latter such advances as they may require. In this fashion, the bank is supposed to balance the surpluses and deficits of the constituent banks. Although the constituent banks are expected to deal primarily with the Provincial Bank, there is in practice some direct inter-lending between one central co-operative bank and another. The bank accepts current deposits and fixed deposits from the constituent banks as well as savings

deposits and fixed deposits from the general public on which it pays varying rates of interest.

Relevant statistics in connexion with the working of the Provincial Bank are furnished in the table on the opposite page, which also bears testimony to the rapid growth of the institution.

As the principal function of the Provincial Co-operative Bank is to assist the central banks, its operations exert little influence on the Calcutta money market. There are, however, two ways in which a link with the organized money market may exist.

In the first place, the Provincial Bank sometimes acts as a guarantor in respect of loans obtained by a registered society from another bank. It has, for example, assisted central co-operative banks to obtain accommodation from the Imperial Bank under the cash-credit arrangement. It is, however, generally understood that such accommodation will be utilized by the central banks for short-term requirements. The Provincial Bank charges a small commission as its guarantee fee.

In the second place, there is the question of linking up the co-operative banking structure of the country with the Reserve Bank through the agency of the Provincial Co-operative Bank. Under the Reserve Bank Act, financial accommodation from the Reserve Bank to the co-operative movement may be available under the following heads: [1]

(*a*) Loans and advances against Government securities for periods not exceeding ninety days to provincial co-operative banks, and through them to central co-operative banks.

[1] *Functions and Working of the Reserve Bank of India*, p. 71.

Loans and Deposits of the Bengal Provincial Co-operative Bank

Year	No. of So-cieties	Paid-up Capital	Reserve Funds	So-cieties	Central Banks	Individual and other sources	Total working Capital	Profit and Loss	Rate of Interest %	
									Loans	Deposits
		Rs	Rs				Rs	Rs		
1917-18	31	82,625	..	41,152	76,172	12,78,046	14,77,995	+3,552	6¾–7	7½
1920-21	72	2,97,500	12,642	5,985	3,94,011	13,30,907	20,41,045	+36,830	4½–7	6½-7½
1925-26	136	6,98,425	1,44,109	6,70,978	15,87,192	44,29,826	75,30,530	+1,45,645	3–6¼	7-7½
1930-31	160	16,45,300	5,58,022	8,33,481	22,86,695	1,46,42,498	1,99,65,996	+1,18,874	3–7	7½-8
1935-36	163	16,70,325	20,56,241	19,58,203	45,33,632	1,31,02,201	2,33,21,602	+1,60,330	3½	8½

(*b*) Similar loans and advances to provincial co-operative banks against approved debentures of recognized land-mortgage banks which are declared trustee securities, if the bank considers that the debentures are readily marketable.

(*c*) Discount of Treasury Bills.

(*d*) Loans and advances for periods not exceeding ninety days to provincial co-operative banks against promissory notes of approved co-operative marketing or warehouse societies endorsed by provincial co-operative banks and drawn for the marketing of crops; or rediscount of such promissory notes maturing within nine months; or loans and advances for periods not exceeding ninety days on the promissory notes of provincial co-operative banks secured by warehouse warrants issued by corporations independent of the borrower or on the security of promissory notes supported by documents of title to goods which have been assigned or pledged as security for cash-credits or overdrafts granted by provincial co-operative banks to approved marketing or warehousing societies.

(*e*) The Reserve Bank will also on occasions be prepared to make advances to provincial co-operative banks for a maximum period not exceeding ninety days against promissory notes of central co-operative banks and drawn for financing seasonal agricultural operations or the marketing of crops; or rediscount of such promissory notes maturing within nine months.

There are, however, certain conditions governing the assistance which the Reserve Bank may offer to provincial

co-operative banks even under the heads mentioned above. For one thing, the Reserve Bank will not supply normal finance. It will supply finance only in times of emergency or seasonal stringency. For another, the Reserve Bank will deal with only such provincial co-operative banks as are run on approved banking lines. The Reserve Bank has already indicated the criteria of sound banking in one of its circular letters. Thus, co-operative banks seeking assistance should maintain liquid resources consisting of cash, balances with bankers and Government securities, of at least 40 per cent of their liabilities. Further, they should ordinarily confine their business to short-term loans, which in normal course should be repayable within nine to twelve months. Again, a provincial co-operative bank should maintain with the Reserve Bank cash balances which at the close of business on any day shall not be less than 2½ and 1 per cent of its demand and time liabilities respectively, and also submit to the Reserve Bank periodical statements prescribed for the purpose.

Although co-operative banks may obtain accommodation from the Reserve Bank under certain conditions, it is extremely doubtful if they will be in a position to avail themselves of such facilities. It will not be easy for them to separate their long-term debts from short-term obligations or satisfy the reserve requirements indicated by the Reserve Bank. Further, agriculture is such a hazardous occupation and so much dependent upon the vagaries of the climate that it is hardly likely that loans granted by credit societies for even cultivation finance will always be promptly repaid. In these circumstances and as the Reserve Bank must needs maintain absolute liquidity in its position, Professor Niyogi rightly observes[1] that the Reserve Bank will hardly be in a position to grant

[1] *The Co-operative Movement in Bengal*, p. 140.

loans against promissory notes to provincial co-operative banks or discount such notes issued for cultivation finance. For the essential requirements for enabling the Reserve Bank to offer assistance to co-operative credit institutions are not likely to be fulfilled by them, at least in the immediate future.

CHAPTER VII

CLEARING

NEED FOR A CLEARING HOUSE

A CLEARING House is an essential adjunct of every developed banking system. Its manifold advantages need no elaboration. It prevents frequent and tedious 'walks' by a bank's employees for the collection of cheques and drafts, the payment of these instruments in cash, and the consequent danger of loss in transit, as well as the necessity of holding by each bank of large cash balances with prejudicial effects on the efficiency of the banking system.

Banking transactions in Calcutta reach a very high figure and are much in excess of those in any other financial centre in India. Settlement between banks in respect of funds drawn by means of cheques and drafts upon one another are effected through the Calcutta Clearing House, which is managed by the Calcutta Clearing Banks Association. Prior to the establishment of the Reserve Bank, the premises of the Association were located in the Imperial Bank Head Office building on Strand Road, and final settlements between member banks were effected by means of cheques drawn upon the Imperial Bank. With the establishment of the Reserve Bank, however, final settlements between clearing banks are now effected through the Reserve Bank, although the premises of the Association have continued to be located in the Imperial Bank building on Strand Road.

The Calcutta Clearing Banks' Association

The Calcutta Clearing Banks' Association is now governed by the new regulations and Clearing House rules adopted

on September 21, 1938. At that time, there were 25 members and 8 sub-members of the Associations.

Members

The twenty-five banks, which were members of the Association, were entitled to be described as clearing banks. They are: Allahabad Bank, American Express, Bank of Baroda, Bank of India, Central Bank of India, the Chartered Bank, Comilla Banking Corporation, Comilla Union Bank, Eastern Bank, Grindlay & Co., Hongkong and Shanghai Banking Corporation, Imperial Bank, Lloyds Bank, Mercantile Bank of India, Nath Bank, National Bank of India, National City Bank of New York, Netherlands India Commercial Bank, Netherlands Trading Society, P & O Banking Corporation, Punjab National Bank, Reserve Bank of India, Thos Cook & Son (Bankers), Yokohama Specie Bank. Since 1938 there has been no new member, while the P & O Banking Corporation has ceased to exist, having been purchased by the Chartered Bank. The present total number of members, therefore, is twenty-four. Of these, apart from the Reserve Bank and the Imperial Bank, thirteen are Exchange Banks, and nine non-Exchange Banks. Of the latter nine, one, the Allahabad Bank, is affiliated to the Chartered Bank. Thus Indian member banks number only eight, of which only four are Bengali banks, namely, Bengal Central Bank, Comilla Banking Corporation, Comilla Union Bank and Nath Bank.

There were in 1938 eight sub-members of the Association, namely, Bank of Commerce, Bengal Bank, Bhowanipur Banking Corporation, Luxmi Industrial Bank, Morris & Morris (Bankers), Pioneer Bank, Southern Bank, Union Bank of Bengal. Since then, there have been four new sub-members, namely, Bank of Behar, Jwala Bank, New Standard Bank, and Calcutta National Bank. Of the sub-members, only two are

non-Bengali banks, namely, Bank of Behar and Jwala Bank. Morris & Morris (Bankers) which has its Head Office in Calcutta, is controlled and managed by non-Bengalis.

Qualification for Membership

To qualify for membership, a bank must have a paid-up capital of not less Rs10 lakhs or the equivalent thereof in other currency, and also an office in the City of Calcutta or elsewhere within the area to which the clearing extends. A bank so qualified must send in an application to the Secretary of the Association duly proposed and seconded, and becomes a member only on condition that the application is supported by three-fourths of the members on the roll of members.

Qualification for Sub-membership

A bank having a paid-up capital of not less than Rs5 lakhs and an office in the City of Calcutta or elsewhere within the area to which the clearing extends is qualified to be a sub-member. An application for sub-membership in a prescribed form has to be submitted to the Secretary of the Association through a member of the Association, called the 'sponsor member', along with the latest audited balance sheet of the applicant. The sponsor member has further to sign an undertaking in a prescribed form to be responsible to the Association for all obligations and duties of the applicant to the Association, if elected a sub-member. To be elected a sub-member, the applicant must be supported by not less than two-thirds of the members of the general committee of the Association.

Management

The affairs of the Association are managed by a general committee consisting of the President and the Vice-President

and eight other officers of members of the Association to be nominated as follows:—

(i) Five nominees of Exchange Banks who are members.
(ii) Three nominees of non-Exchange Banks who are members, exclusive of the Imperial Bank and the Reserve Bank.
(iii) One nominee each of the Imperial Bank and the Reserve Bank.

The five Exchange Banks and the three non-Exchange Banks which shall be entitled to nominate a member of the general committee for the ensuing year shall be elected annually at the annual general meeting. It is further provided that the offices of the President and the Vice-President shall, if possible, be held alternately by an officer of a member Exchange Bank and a member non-Exchange Bank.

The general committee has power to appoint sub-committees for such purposes as may be deemed expedient and in particular a sub-committee to manage the Clearing House. Authority for appointments is vested in the General Committee, which is also entrusted with the task of arranging for premises for the purposes of clearing. It also appoints a Supervisor of the Clearing House to control and supervise the daily clearings in accordance with the Clearing House rules for the time being in force.

Procedure for Clearing

All cheques, bills and other documents payable at the office of a member or a sub-member in Calcutta may be passed through the Clearing House. It is provided, however, that dividend warrants and telegraphic transfer receipts shall be accepted only at the first clearing, and, except on Saturdays, they cannot be returned through the special clearing. A sub-member is

not entitled to deliver direct any document to be cleared on its behalf through the Clearing House. Documents of a sub-member must be submitted through its sponsor member whose representative in the Clearing House will incorporate such documents in the Clearing House Register of the sponsor member.

Each member or sub-member has to provide for the use of its representative attending the Clearing House a Register suitably ruled in which a record of the documents received and delivered by him in the Clearing House will be entered.

Each member enters into a separate delivery slip a list of documents in detail with the total number and amount thereof. This total is entered into the Register against the particular bank. This procedure is repeated in case of documents received against all other member banks at each delivery, of which there are four for Monday to Friday, and three for Saturday. The representative of the clearing member at the Clearing House hands over to the representative of each drawee member the documents deliverable to him together with a delivery slip; the representative of each drawee member thereupon enters the documents in his Register. After comparing the delivery slips with the documents received and verifying the totals, each representative totals the receipts and deliveries in his Register, strikes a balance therein, showing the net amount due to or by his principal, and hands over the Register to the supervisor of the Clearing House, who then strikes the gross balance of the whole.

Clearings

There are two ordinary clearings on each business day, excepting Saturdays, when there is only one, according to the following tables:

On Mondays to Fridays [1]

1st Clearing—12 noon		2nd Clearing—3 P.M.	
Times for deliveries		Times for deliveries	
11 A.M.	12 noon	2 P.M.	3 P.M.

On Saturdays

Clearing 12-45 P.M.		
Times for Deliveries		
11 A.M.	12 A.M.	12-45 P.M.

In addition to these ordinary clearings, there is a special clearing on Mondays to Fridays at 5 P.M. and also on Saturdays at 2-30 P.M. for clearing returned documents, debit notes received in lieu of documents presented through the first clearing and returned unpaid, and debit notes issued in adjustment of differences in either clearing that day. Formerly there were no special clearings, and their introduction was probably due to apprehension entertained in respect of debit notes received in connexion with the second clearing being left over until the next day.

Since the above rules were adopted in 1938, some alteration has had to be effected in regard to Saturdays' clearing on account of the enactment of the Bengal Shops and

[1] Clearing hours have been changed recently on the introduction of the Indian Standard Time. All timings quoted here refer to Calcutta time.

Establishments Act. There are now two deliveries on Saturdays at 10-30 A.M. and 11-30 A.M., and the special clearing on Saturdays takes place at 1 P.M.

In the case of non-payment of documents, they have to be returned to the member presenting them in the following manner. Unpaid first clearing documents have to be returned before 2 P.M. direct to the presenting member, who either pays cash in exchange or issues a debit note to be presented through a subsequent clearing. Unpaid second clearing and Saturdays' clearing documents have to be returned before 5 P.M. on Mondays to Fridays, and before 1 P.M. on Saturdays.

Final settlement of balances is effected by the Supervisor of the Clearing House by debiting or crediting, as the case may be, the accounts of the member banks with the Reserve Bank.

Metropolitan Banking Association

Its Origin

The Calcutta Clearing Banks' Association serves only the large banks in Calcutta and a few others who have been accepted as sub-members. A large number of banks functioning in the city of Calcutta thus remain outside the scope of its operation. The collection of cheques, drafts, etc. drawn on these non-clearing banks, has been a matter of considerable difficulty and controversy. Until a few years ago, these cheques used to be collected by the clearing banks without any charge by sending round their durwans to the various drawee banks and obtaining cash over the counter. With the rapid growth in number of these banks in Calcutta this procedure proved to be both expensive and time-consuming. And clearing banks began to impose a charge for the collection of cheques, drafts, etc. on non-clearing banks, and some of them even refused to accept such cheques for collection. Both these practices reacted very unfavourably on the

business and prospects of the non-clearing banks. For, the public was not likely to maintain accounts with banks, whose cheques suffered serious handicaps and were almost treated as pariahs in the market. The Metropolitan Banking Association owes its origin to the imperative need felt by the non-clearing banks to remove these crippling handicaps on their business and prospects of expansion. Calcutta thus claims two Clearing Associations, operating side by side and within the same area, and records a distinct advance on conditions which obtain in Bombay. There is no comparable institution like the Metropolitan Clearing Association in Bombay, and until recently there was no uniformity in the rates charged by the clearing banks for the collection of cheques, drafts, etc. on non-clearing banks. Of late, the Bombay Clearing House has adopted uniform rates for the collection of cheques, drafts, dividend warrants, etc. on non-clearing banks.

The Metropolitan Banking Association, which conducts the Metropolitan Clearing House, was founded in 1939, but it was not until July 1940 that an understanding was arrived at with members of the Calcutta Clearing House.

Membership

The Association is barely two years old. It is still in its infancy and no restrictions are as yet imposed on banks seeking membership. It was ascertained on enquiry that the stabilization of the position of the institution, consequent on the growing recognition of the useful work it was doing, would soon make it necessary to lay down certain standards which applicants for membership would have to fulfil. There are now over fifty member banks of the Association.

Management

The conduct of the affairs of the Association is vested in an executive committee consisting of the President, the Vice-President and nine other members, all elected at the annual general meeting. The executive committee elects an honorary Secretary of the Association, as well as a sub-Committee of three from among its members for the conduct of the business of the Metropolitan Clearing House. It also appoints a Superintendent for the Clearing House, who is a salaried official.

Procedure of Clearing

The Association now conducts only one clearing on every working day through its Clearing House. Each member of the Association has allotted to itself a separate counter attended to by its clerk. Cheques or other articles payable on demand drawn on member banks and received by other member or non-member banks, whether members of the Calcutta Clearing House or not, have to be presented at the Clearing House between the hours of 11-45 A.M. and 1 P.M. on ordinary business days and between 11 A.M. and 12 noon on Saturdays. Although the clearing rules say that cheques and other articles, payable on demand, drawn on member banks and presented by members of the Calcutta Clearing Banks' Association, shall on presentation be either paid in cash or returned immediately with return slips, this procedure is not actually followed as it was found in practice to be inconvenient.

The procedure actually followed is as follows. Cheques and other articles received at the Clearing House are distributed to the representatives of the banks on which they are drawn. These representatives then leave for their respective offices with the cheques and return to the Clearing

House by 2 P.M. with either cash or return slips for articles that will be returned unpaid. The clerks and durwans of the collecting banks return to the Clearing House about this time, and all payments in cash are made and received between 2 P.M. and 3 P.M. Cheques not paid are returned with return memos.

All settlements, it will be noted, are effected in cash. Another peculiarity is that balances are not as yet struck between debits and credits of even member banks. Full amounts for cheques and other articles presented are paid or received in cash, excepting, of course, those which are returned unpaid. It was, however, ascertained on enquiry that the Association had already reached a stage where it might reasonably hope to introduce at an early date not only a system of striking balances between debits and credits of member banks, but also of making all settlements by means of vouchers or transfer cheques.

Pioneer Clearing

In addition to the clearings conducted by the Calcutta Clearing Banks' Association and the Metropolitan Banking Association for their respective members and sub-members, another novel method of clearing has of late been evolved in Calcutta, which is called 'Pioneer Clearing'.

Pioneer Clearing is a form of clearing which operates within the ambit of the Calcutta Clearing House but carries with it no official sanction or recognition. In theory, it is nothing but a private arrangement between a member bank and a non-member bank,—an arrangement which may or may not be recognized by other member banks. In practice, however, this arrangement has so far been recognized by member banks, and has many advantages both to themselves, as well as to the non-member banks, which are in a position

to avail of it. A description of the actual working of this form of clearing will bring out its various implications.

Let us suppose X is a member bank and Y a non-member bank, having an account with X bank. Then Y may enter into an agreement with X that all cheques, drafts, etc. drawn on Y should be cleared through X, which is a member of the Calcutta Clearing House. All cheques, drafts, etc. drawn on Y bear an instruction to the effect 'clear through X'. Generally, this instruction is printed on the body of the cheque. Other member banks which receive cheques, drafts, etc. drawn on Y treat them as if they were drawn on X, and list them under X, and their total amount is also debited to X. When X receives all cheques, drafts, etc. listed against it through the Clearing House, it sorts out the cheques, drafts, etc. drawn on Y, and hands them over to the representative of the latter after debiting the total amount for which cheques, drafts, etc. on Y have been received to Y's account with X. Y's representative then proceeds to his bank with the instruments, and, after the latter have been verified, returns such of them as are not payable to X with approved objection slips. X, thereupon, credits the amount for the returned cheques, drafts, etc. to Y's account, and returns them along with its own returned cheques with approved objection slips in each case to the Clearing House. It will, thus, be seen that the system works, in essentials, as if Y were simply a constituent of X. In so far as the Calcutta Clearing House is concerned, Y has no independent status and is not recognized by the former. Other member banks may or may not abide by the instruction written on Y's cheques to the effect that they should be cleared through X. In practice, however, they have so far followed such instructions. Whenever cheques, drafts, etc. with written instructions on them to the effect that they should be collected through particular member

banks circulate, it is the usual practice for other member banks to write to the member banks concerned through whom cheques of particular non-member banks are instructed to be cleared as to whether it would be in order for these other member banks to clear the cheques of these non-member banks through the particular member banks, with whom these non-member banks are presumed to have made arrangements. On receipt of an affirmative reply, other member banks list the cheques, drafts, etc. of these non-member banks on the member banks concerned for purposes of collection, although, it should again be recalled, they are not obliged to do so.

The advantages of this system of pioneer clearing are obvious. In so far as non-member banks are concerned, they can avail of practically all the advantages of the Calcutta Clearing House. They, however, do not obtain the status in the market which membership- or sub-membership of the Calcutta Clearing House ensures, and have also to suffer the indignity of having to have their cheques, drafts, etc. marked as 'clear through X bank'. The advantage that accrues to member banks is that of easy collection of cheques, drafts, etc. drawn on these non-member banks.

It is, however not likely that many non-member banks will be accepted by member banks for this unofficial system of pioneer clearing. For, the arrangement involves considerable responsibility on the member bank concerned, and it is not likely to agree to the facilities being offered to a non-member bank unless it were absolutely convinced about the soundness and stability of the latter. For in the event of the non-member bank being unable to meet its obligations, the member bank, through which its cheques, drafts, etc. were cleared, will be liable to the other member banks for cheques, drafts, etc. received by it on behalf of its constituent, the non-member

bank. If the non-member bank fails to meet the demands made upon it, and if, further, its balance with the member-bank falls short of these demands, the member-bank itself will be liable to make good any deficient balance. Cheques, drafts, etc. on the non-member bank can be returned, it should be recalled, only with 'approved' objections. It is the presence of this contingent danger that is likely to debar member banks from offering to all and sundry non-member banks the facilities ensured by the system of pioneer clearing.

Only three banks have up till now been admitted to the advantages of this system. They are the United Industrial Bank, the Dinajpore Bank and the Hooghly Bank. The United Industrial Bank clears its cheques, drafts, etc. through the Imperial Bank of India, and the other two banks through the Comilla Banking Corporation.

Walks Clearing

There are two Bengali Scheduled Banks which are neither members nor sub-members of the Calcutta Clearing Banks' Association nor members of the Metropolitan Banking Association. They have not been admitted to either the membership or sub-membership of the former, and they have not joined, presumably on grounds of prestige, the latter, whose members are all non-scheduled banks. They are the Calcutta Commercial Bank, and the Noakhali Union Bank. The cheques, drafts, etc. on these banks are collected by members and sub-members of the Calcutta Clearing Banks' Association free of any charge. The instruments for collection received by the latter on these banks are sorted out under the different paying banks. Messengers are then sent round to present these instruments to the paying banks and obtain cash in return. These banks, in their turn, adopt the same procedure

in collecting cheques, drafts, etc., received by them drawn on the other banks.

Apart from the case of these two scheduled banks, which are members of neither Clearing Association, there is no definite procedure for the collection of cheques, drafts, etc., drawn on similarly placed other small banks in the city of Calcutta. Members or sub-members of either Clearing Association may refuse to collect these instruments or levy such charges as they like for their collection. Fortunately, the number of such smaller banks in the city of Calcutta is very small.

CHAPTER VIII

INSTITUTIONS OF THE BAZAAR MONEY MARKET

A. THE INDIGENOUS BANKER

BY far the most important constituent of the bazaar money market is the indigenous banker. To describe the organization as well as the operations of indigenous banking is, however, not an easy task. As the indigenous banker is, as a rule, very secretive and resents enquiries about his business organization, methods and activities, it is extremely difficult to provide information, particularly when it is of a statistical nature, on these subjects. The following quotation from a letter written by a Multani banker to the Reserve Bank bears ample attestation of the resentment of indigenous bankers to any suggestion of an enquiry into their business operations: 'Our business is based on strict privacy and it will greatly hamper our business if we make up our mind to show our account books'.[1] The Central and Provincial Banking Enquiry Committees provide some information, mostly of a descriptive character. But even such information appears to have become out-dated or to be defective in many respects. The description provided here is based on private enquiries and discussions undertaken with the representatives of some of the important indigenous banking firms in Calcutta. Information obtained from one source has been checked by that secured from other sources. This description of the organization and operations of the indigenous bankers refers to conditions obtaining in the Calcutta money market only.

[1] *Statutory Report of the Reserve Bank of India*, 1937, Appendix C.

Definition

The Indian Central Banking Enquiry Committee defines an indigenous banker or bank as an individual or private firm receiving deposits and dealing in hundis or lending money. Those who do not receive deposits were to be treated as money-lenders. Acceptance of deposits was thus intended to be the distinguishing feature of an indigenous banker. The Reserve Bank also in its Statutory Report, submitted in 1937, laid emphasis on the necessity of developing by the indigenous banker the deposit side of his banking activities, if he were to come into practical relationship with the Bank. In practice, however, this definition was found unsatisfactory. The Bombay Provincial Banking Enquiry Committee observed that it 'could not dissociate from the indigenous bankers the Multani Shroffs who do not deal in deposits, but who have for all practical purposes been regarded as bankers'.[1] The U.P. Provincial Banking Enquiry Committee observed that indigenous bankers do not usually accept deposits as they consider it derogatory to their dignity, although it should be added that the Marwari Chamber of Commerce, Bombay, which should be conversant with the practice of Marwari Shroffs, maintained in their evidence before the Indian Central Banking Enquiry Committee that 'we do accept deposits'. In fact a large section of the Marwari Shroffs do accept deposits. In the opinion of the Bengal Provincial Banking Enquiry Committee there were not many indigenous bankers at the time who received deposits. Further, many of those bankers who previously used to receive deposits had since ceased to do so. The Bengal Committee, therefore, defined indigenous bankers as 'individuals or firms who deal in hundis, whether they accept deposits or not'.[2] Dealing in hundis and not acceptance

[1] Report, para 251.

[2] Report, para 371.

of deposits is thus made the distinguishing characteristic of the indigenous banker. As this definition conforms more to actual fact than the one enunciated by the Indian Central Banking Enquiry Committee and accepted by the Reserve Bank, it is followed in this description. The indigenous banker is also popularly known as shroff, and should be distinguished from a sowcar, who is a money-lender.

Importance of the indigenous banker in the Indian economy

Until the establishment of modern joint-stock banks the indigenous banker enjoyed a virtual monopoly of banking in the country. With the advent of joint-stock banks, however, his importance has suffered considerable deterioration. Yet, despite competition from well-organized banks, a good deal of banking business still remains in his hands. And he still occupies a predominant position in areas which are not, or are only poorly, served by joint-stock banks. Like the Indian joint-stock banks, his share in the financing of foreign trade is negligible. But amongst the agencies financing internal trade and industries, especially in the matter of the provision of their working capital, he occupies an important position. He does not engage to any large extent in financing agriculture directly. But he renders considerable assistance to agriculture indirectly by lending money to village sowcars. The Bombay Committee observed [1] that the shroff sometimes provides even the long-term capital needs of industries. In certain places he holds debentures in industrial concerns, and advances money against deposit of shares. Occasionally he also gives long-term loans against the security of fixed capital of industrial establishments.

[1] Para 262.

Classes of indigenous bankers

There are in Calcutta four principal classes of indigenous bankers, viz.,

1. Marwari
2. Multani
3. Bengali
4. Gujarati

Of these classes the Marwaris were until lately the most important in Calcutta. In recent years the Multanis have forged ahead, and probably rank in importance today even more than the Marwaris. After these two classes come the Bengalis and the Gujaratis in order of importance.

There are today only seven important Multani firms in Calcutta. In addition to these seven firms, there are a few other Multani bankers, who periodically visit Calcutta and invest funds here. They have no offices in Calcutta, but may sometimes have agencies here.

There are many firms of Marwari bankers in Calcutta. They used to do a flourishing business up to a few years ago. Internal division between partners in a firm, preoccupation with other businesses, including speculative ones, and the apprehensions caused by the enactment of the Bengal Money-lenders' Act have all contributed to a progressive dwindling of their business.

There are only three Bengali firms in Calcutta, which undertake regular hundi business. Since the outbreak of the war and the enactment of the Bengal Money-lenders' Act their business has undergone a catastrophic decline.

The Gujaratis are of little importance as bankers. Their main business is trading.

Association of indigenous bankers

In contrast to Bombay, where there are a few associations of different classes of indigenous bankers, Calcutta possesses practically no Association of indigenous bankers. There is, however, an unregistered Association of only Multani bankers, called the Sindhi Bankers Association. Its sole function is to fix the rate of interest to be charged from borrowers who approach more than one banker for accommodation. Thus the main purpose of the Association is to prevent cut-throat competition among the Multani bankers themselves. In the absence of such an Association a borrower could approach one banker and ascertain his terms, and then approach another banker and tell him of the rate quoted by one of his competitors so as to obtain a still cheaper rate, and so on. The Association, by fixing the rates of interest to be charged to such borrowers, prevents ruinous competition among its members. The Association does not interfere in the case of such borrowers who have dealings with only one banker.

Nature of business

It is a common saying that a peculiarity of the indigenous banker is that he seldom engages in banking business only. Thus the Bombay Provincial Banking Enquiry Committee remarked that he 'does not draw any distinction between dealing in other people's money, and dealing with other people's money'.[1] Apart from the consideration that the indigenous banker as often as not relies on his own resources only, the statement that he seldom engages in only banking business is not wholly true. For the Multani bankers deal only in banking business to the exclusion of any other trading activity. As they constitute today the most important

[1] Report, para 255.

category of indigenous bankers, it can no longer be stated as a general proposition that indigenous bankers do not carry on banking business only.

It is pertinent to observe, however, that, speaking historically, there was some justification for the combination of trading with banking business. At a time when banking facilities were lacking, trading relations often gave rise to demands for financial assistance by customers, with the result that traders developed banking functions. This fact has not lost all its significance even today, for dealers, particularly small dealers, cannot easily obtain accommodation from financial institutions. In offering financial help, the trader-cum-shroff had, and still possesses, the great advantage of an intimate knowledge of his customer's position and financial standing. Banking business also helped the trader-cum-shroff in the remittance of his funds and the collection of his dues.

In certain cases, particularly with the Marwaris, while their other activities have increased, their banking business has suffered some decline, as a result of the growth of joint-stock banking. The indigenous banker finds it difficult to compete with the Imperial Bank in remittance business, with the co-operative banks, which have the support of the Government, in attracting deposits, and with the joint-stock banks in the matter of loans and advances. Withal, his long and friendly association with a large clientele, the informality of his business and the honesty of his dealings, have enabled him to maintain his connexions with a large number of customers.

In so far as the Calcutta market is concerned, we may quote the opinion of the Bengal Banking Enquiry Committee which stated that 'the majority of the indigenous bankers combine banking with some form of trade, wholesale or retail'. It added that it had come across only two firms in

Dacca which carried on the business of banking alone. Its assessment might have been true at the time it reported, for the Multani bankers had not then set up business in this province. Their advent in the Calcutta market dates from about 1935 or 1936. The Marwaris, who were prior to this time and continued for some years even thereafter to be the most important group of indigenous bankers in Calcutta, used to combine both trading and banking businesses. It was, however, ascertained on personal enquiry that previously there were just a few Marwari firms, which were pure bankers. Today no such Marwari firms exist, for banking and trading businesses are intermixed.

If, in accordance with the comparative importance of banking or trading business, indigenous bankers are grouped under the following three broad categories, viz.,

(*a*) those who do no business other than banking;
(*b*) those who are both bankers, traders and commission agents; and
(*c*) those who are principally merchants or traders, but who also employ their surplus funds in banking business,

their division in the Calcutta market will be something as follows. The Multanis will belong to the first category, the Marwaris and the Bengalis to the second, and the Gujaratis to the third. Of firms which carry on both banking and trading businesses, no separate accounts are usually maintained for the different branches of their business, nor do they have any separate establishments nor ear-mark particular funds for different sections of their business. As the controlling authority in the different branches of business is vested in the same hands, work is greatly facilitated and expenses of management are reduced to a minimum.

Inter-relation between indigenous bankers

The relationship between indigenous bankers is, on the whole, cordial. This relationship manifests itself in three respects. In the first place, inter-borrowing of money, when any of their members is short of funds. In the second place, remittance facilities offered to one another to and from places, where branches or offices exist. The actual working of these operations will be detailed in Part II. In the third place, indigenous bankers supply each other on request references in respect of their parties, i.e., borrowers. Bankers in either category may approach members of any other category for such information, and the request is always complied with.

Relations with Customers

All the Banking Enquiry Committees, Central or Provincial, reported very highly of the integrity of the indigenous banker, and the respect and friendliness with which he is looked upon by his customers. The indigenous bankers are not merely bankers to their clientele, but often also their trusted friends and advisers. Further, they keep in close touch with their customers, and are often intimately acquainted with their material condition and the nature of their business. This knowledge is of great advantage to the indigenous bankers in their business operations.

Relations with Commercial Banks

Indigenous bankers normally work with their own capital, supplemented in some cases by deposits from the public. But in busy seasons or during periods of active demand for loans, their resources may prove inadequate and they are forced to take resort to banks for financial assistance. Commercial banks,—both Indian joint-stock and Exchange banks—

however, render assistance to only such indigenous bankers as are on their approved lists. There are limits fixed for each shroff, who is on the approved list, by banks, up to which he can draw. The advances are usually made by discounting hundis.

Complaints have often been made by indigenous bankers that neither the Imperial Bank nor the commercial banks accord them the recognition due to them as bankers.[1] They resent the way in which the Imperial Bank undertakes enquiries, and consider it unfair that they were not accorded the same facilities as were offered to commercial banks. On the other hand, the Imperial Bank urged that, unlike commercial banks, not only do the indigenous bankers maintain, generally speaking, no balances with the Imperial Bank, but, further, that it was often difficult to distinguish their genuine banking operations from other businesses.

It would appear that the commercial banks as well as the Imperial Bank evince no discrimination against the indigenous bankers, and that, provided they are satisfied about their credit and standing, they accord them all reasonable assistance. It is interesting to observe, however, that all classes of indigenous bankers do not receive the same liberal assistance from commercial banks. Multani bankers are preferred to other classes of indigenous bankers, and the main reason is that they carry on banking business only. The Marwari shroffs find it somewhat difficult today to obtain accommodation from commercial banks because they carry on business other than banking, and especially because they engage in speculative operations. A respectable Marwari shroff himself admitted that in previous years, particularly during the time of the Presidency Banks and even for some time after

[1] *Bombay Provincial Banking Enquiry Committee Report*, para 264.

their amalgamation, Marwaris obtained liberal assistance from the Presidency Banks or the Imperial Bank as well as other commercial banks. But ever since they began to engage in speculative businesses, this accommodation has been severely curtailed. The Bengali shroffs do not approach the commercial banks for accommodation against rediscounting of their hundis. The position today is that, provided a commercial bank is satisfied about the credit and standing of an indigenous banker, the latter should have no difficulty in obtaining from the bank every reasonable financial assistance. The indigenous bankers themselves, and particularly the Multani shroffs in Calcutta, testified to this.

In Calcutta, the indigenous bankers approach the commercial banks directly for accommodation. In Bombay, however, although applications for accommodation are generally made by indigenous bankers direct to the commercial banks, they are usually negotiated through the intermediary of recognized brokers, whose services are of course paid for by the indigenous bankers.

Relations with the Reserve Bank

One of the proposals of the Central Banking Enquiry Committee for linking up the indigenous bankers with the general banking system was that 'as soon as the Reserve Bank is established, the indigenous banker should along with joint-stock and co-operative banks be brought into direct relations with the Reserve Bank, and thereby provided with rediscount facilities from that institution'[1]. An obligation was also imposed upon the Reserve Bank, vide Section 55(i) of the Reserve Bank of India Act, to submit to the Governor-General within three years from the date the Act came into force,

[1] *Report*, pp. 56–58.

proposals for the extension of the provisions of the Act to indigenous bankers, as well as for effecting a closer connexion between agricultural enterprise and the operations of the bank. Accordingly in the Statutory Report submitted by the Reserve Bank in 1937, certain proposals were put forward for compliance by the indigenous bankers for the purpose of linking them directly to the Reserve Banks. These proposals are detailed in an annexure to the Statutory Report. The most important of the conditions laid down by the Reserve Bank, which indigenous bankers will have to fulfil to qualify themselves to be linked up with the Bank, reads as follows: 'They must confine their business to banking proper as defined by the Indian Companies Act. Any other business that they might be conducting should be wound up within a reasonable time'.[1] Among other conditions are the requirement to maintain proper books of account, to have them regularly audited, and the right of the Reserve Bank to inspect accounts and call for any necessary information as well as the right of the Bank to regulate the business of indigenous bankers on banking lines. These proposals were in their essentials opposed by the indigenous bankers. In a letter written to the Reserve Bank by Mr Chunilal B. Mehta, President of the Bombay Shroff Association, it was suggested that 'there has hitherto been no call and inducement to the indigenous banker to indicate any general desire to limit and develop his business on the lines suggested by him. No valuable privilege has been held out to the indigenous banker, and no facility has been offered hitherto to make him go out of his way to curtail his activities and to adopt forms of business, which are convenient to the joint-stock banks, but which would be somewhat inconvenient to him'.[2] Mr Mehta further maintained

[1] *Statutory Report*, p. 56.
[2] *Statutory Report*, p. 61.

that banking business as defined in the Companies Act covered most of the activities of the indigenous bankers as commission agents, and that, without asking them straightway to discard their family businesses, the Reserve Bank should have first started dealings with the indigenous bankers and then ascertained if the continuance of any particular business would have entailed for the banking business such serious risk as to demand its discontinuance. In another letter [1] written by a Multani banker to the Reserve Bank, the Multani banker expressed his agreement with the condition that the indigenous banker should not carry on any business other than banking, but strongly opposed the proposals to have his accounts audited or inspected. He added: 'If the Reserve Bank wishes to do business with the indigenous bankers on the lines of the Imperial Bank and other banks, the step would be most welcome . . . but on the terms and conditions mentioned by you we may assure you no banker with self-respect would come to your door to have the facility of discounting bills with you'. In view of such adverse reception of the proposals sponsored by the Reserve Bank for linking the indigenous bankers to it, the bank dropped them for the time being, adding that they remained open for acceptance by the indigenous banks, should they change their opinion in future.

It is, however, not likely that the indigenous bankers will ever agree to the Reserve Bank's proposals. Nor is it possible for the Reserve Bank, consistent with its responsibilities and functions, to admit them directly as its constituents unless its proposals are in their essentials agreed to. As the question of the direct linking up of the indigenous bankers with the Reserve Bank is not now found to be a practicable one, the

[1] *Statutory Report*, Appendix C.

only possible solution, as suggested by the Bank, is the development of an open bill-market in which first class bills will be freely negotiated. 'If such a market could be developed it would be possible for us (the Reserve Bank) to extend our open market operations to trade bills as we do at present to Government securities, and this would give first class indigenous bankers the closer and possibly ultimately the direct relationship which they desire, without compelling them to modify the essential character of their business or to submit to unduly rigid restrictions'.[1]

The indigenous banker and the Bengal Money-lenders' Act, 1939

The Bengal Money-lenders' Act should not affect the business of the indigenous banker quâ banker. For his business is to lend money by means of a hundi, and the latter does not come under the purview of the Money-lenders' Act. Only if moneys are lent against promissory notes will the provisions of the Act become operative. Even then the Act excludes from its scope a commercial loan, which means a loan advanced to any person to be used solely for the purposes of any business or concern relating to trade, commerce, industry, mining, transport, etc.

From personal enquiries, it was ascertained that the business of the Multani bankers has not been affected by the enactment of the Money-lenders' Act. The business, however, of the Marwaris and Bengalis has been affected, although there is no rational basis for this. The reason is more psychological than real, and the fact that they have become concerned about their operations in view of the passage of the Money-lenders' Act probably bears testimony to their functioning to some extent, small or large, as pure money-lenders.

[1] *Statutory Report*, p. 43.

B. THE MONEY-LENDER

The money-lender is an important indigenous credit agency, particularly in rural areas. The fact which distinguishes him from the indigenous banker is that he does not usually deal in hundis. He does not also, generally speaking, accept deposits. Further, while the indigenous banker generally finances trade and commerce, the money-lender, particularly in urban areas, finances consumption more than trade. In rural areas, however, the money-lender, although he finances consumption, is at the same time by far the most important credit agency for supplying short or long period financial needs of the ryot. In recent times the enactment of the Bengal Agricultural Debtors' Act and the Bengal Money-lenders' Act has had the effect of contracting the operations of the money-lender, sometimes to the serious detriment of the interest of the cultivators, as alternative and satisfactory rural credit agencies have not been evolved.

Classification of Money-lenders

The professional money-lenders can be divided into two broad classes, resident and itinerant. The former category is also known as the *mahajan* or *sowcar*. The itinerant money-lenders are chiefly Pathans from the North-west Frontier Provinces, locally known as Kabulis, Punjabis or Peshawaris.

Apart from the professional money-lenders, there can also be recognized a class of persons with surplus funds at their disposal, who utilize them in the business of money-lending. They may be regarded as casual money-lenders. Since the enactment of the Bengal Money-lenders' Act, anybody who carries on the business of money-lending has to obtain a licence and the distinction therefore between professional and casual money-lenders will cease to have its earlier significance.

Loans are generally granted by money-lenders against the personal security of the borrower; the credit instrument being the promissory note. Sometimes collaterals in the shape of ornaments, jewellery, properties or buildings are also offered.

The Bengal Money-lenders' Act

The Bengal Money-lenders' Act received the assent of the Governor-General in July 1940 and came into force in September 1940.

The purpose of the Act is 'to make further and better provision for the control of money-lenders and for the control and regulation of money-lending'. The main provisions of the Act are enumerated briefly.

A money-lender has been defined as a person who carries on the business of money-lending in Bengal, or who has a place of business in Bengal, and includes a pawnee. Money-lending business cannot be carried on six months after the commencement of the Act without an effective licence from the local sub-registrar, who maintains a register of money-lenders. The licence is valid throughout Bengal for a period of three years from the date of issue unless previously cancelled. The licence fee has been fixed at Rs15.

Certain kinds of loans have been excluded from the scope of the Act. Thus a loan has been defined as an advance, whether of money or in kind, made on condition of repayment with interest, and includes any transaction which is in substance a loan but does not include the following:

(*a*) a deposit of money or other property;

(*b*) loans to or by certain societies including co-operative societies;

(*c*) loans to or by any Government in British India or by any local authority in Bengal;

(*d*) loans by a 'scheduled' or a 'notified' bank;
(*e*) loans by insurance companies including provident companies and provident funds;
(*f*) an advance made on the basis of a negotiable instrument as defined in the Negotiable Instruments Act, 1881, other than a promissory note;
(*g*) a commercial loan, i.e., a loan advanced to any person to be used by him solely for purposes of trade, commerce or industry;
(*h*) a loan advanced for the purchase or building of a house together with the site thereof;
(*i*) a loan or debenture in respect of which dealings are listed on any Stock Exchange.

In regard to exception (*d*) above, Section 3 of the Act states that no bank shall be declared a notified bank unless it complies with such conditions as may, with the approval of the Provincial Legislature, be prescribed. The Government have not as yet laid down the rules and requirements for enabling a non-scheduled bank to claim exemption from the scope of the Act as a notified bank. This delay is causing considerable hardship to these banks, and an early announcement of these rules and conditions will remove the uncertainty and suspense under which they have to operate now.

The maximum rate of interest which money-lenders can levy has been fixed at 10 per cent simple on unsecured loans and 8 per cent simple on secured loans, irrespective of the time when the loan was granted. Further, the total amount of interest recovered and recoverable on any loan shall not exceed the principal, and the outstanding interest shall not exceed the outstanding principal. These provisions have been given a retrospective effect.

Probable effects of the Act

The Act was designed to relieve the crushing indebtedness from which ryots suffer as also to remove patent malpractices sometimes resorted to by money-lenders. The objects are no doubt laudable. But it is a moot question whether its provisions have not been made far too stringent. Unnecessarily excessive restrictions upon money-lenders are likely to adversely affect the supply of rural credit. In fact there have been complaints from rural areas that this Act, coupled with the Bengal Agricultural Debtors Act, has considerably accentuated the problem of providing the ryots with necessary finance. Time alone will show whether the Bengal Government in their anxiety to relieve the ryots of the burden of their indebtedness have been wise in making some of the provisions of the Act unnecessarily stringent.

Number of Money-lenders

The Act came into force in September 1940; but work in connexion with registration of money-lenders began in March 1941. From March 1941 up to the end of May 1942, 3,151 money-lenders have been registered in Bengal. Their distribution as between Calcutta and the rest of Bengal is as under:

		No. of money-lenders registered
From March 1941 up to December 1941	In Calcutta ..	290
	In Bengal excluding Calcutta ..	1,569
From January 1942 up to May 1942	In Calcutta ..	60
	In Bengal excluding Calcutta ..	1,232
	TOTAL ..	3,151

PART II

CHAPTER IX

THE RESERVE BANK AS CONTROLLER OF CREDIT

THE organization and the functions of the Reserve Bank have been described in Part I. We shall now examine how its functions are carried out, and in particular how it controls credit. The control of credit in the national interest is in fact the principal function of the Reserve Bank, as it is of any other Central Bank.

Control over Currency and Credit

To effectively discharge this function, the Reserve Bank must be able to control both currency and credit. The control over currency is, of course, of primary significance, inasmuch as it is the basis for credit expansion. This power of controlling currency, and therefore the cash basis, should also ensure ultimate control over bank credit. For banks have to operate on a certain cash basis, which experience and considerations of safety have taught them to be necessary to enable them to meet the demands for withdrawal of funds by their customers. If the media of payment consisted primarily of currency, then control over it would have ensured in large measure control over the credit situation also. If, on the contrary, cheques were the principal medium of payment, as in Great Britain or America, mere control of currency would be of little avail in controlling credit. For control of currency would not affect the volume of bank deposits or 'bank money'. In a country, therefore, where the cheque habit is prevalent, the Central Bank should

also be in a position to exercise control over bank deposits to effectively fulfil its purpose.

Relative importance of Currency and Bank deposits in India

Both silver coin and notes are included under the head currency. Of these two media of payment, the importance of silver coin has greatly declined. The figures of withdrawal from circulation of rupee coins bear testimony to their waning popularity as a means of settling debts. Thus for the 21 years from 1919-20 to 1939-40, there has been a net withdrawal from circulation of over 120 crores of rupees. In fact, ever since 1925-26, with the exception of 1930-31, up to 1938-39, there has been every year a return of rupee coins from circulation. Only in 1939-40, owing to the prevalence of panicky conditions following in particular the debacle of France, was there an absorption of rupee coin to the value of ten crores in circulation.

In contrast to the declining importance of rupee coin is the increasing popularity of notes as a means of payment. For the twenty-one years from 1919-20 to 1939-40 there has been a net absorption of notes in circulation to the value of Rs105 crores. The average for these 21 years is a withdrawal of 6 crores and an absorption of 5 crores per year in respect of rupee coin and notes respectively. It is also noteworthy that, while circulation of rupee coin advanced by Rs10 crores in 1939-40, that of notes increased by Rs45 crores in the same year.

As to the relative importance of notes and cheques as media of payment it is of interest to observe that cheques have been gaining in popularity every year. This is borne out by a comparative study of the volume of notes in circulation and of bank demand deposits over the last few years:

In lakhs of rupees

	Demand Deposits (scheduled banks)	Notes in circulation	Bank clearing
1937-38	1,33	1,86	20,51
1938-39	1,30	1,82	20,12
1939-40	1,40	2,08	23,18
1940-41	1,64	2,41	21,36

This table gives the figures of demand deposits of scheduled banks only. To these should be added the demand liabilities of non-scheduled banks. Further, the greater velocity of bank deposits should also be borne in mind. Thus, while notes still play an important rôle as a means of payment, cheques are becoming increasingly popular, and it is difficult to say if notes are still more important than cheques as a means of settling debts. The position in India in regard to payment by cheques does not of course bear any comparison to that in Great Britain or America, but it probably approximates to that in France.

Statutory Powers of Reserve Bank over Currency and Credit

Inasmuch as both currency notes and bank deposits are equally important in India as media of payment, an effective control over the credit situation by the Reserve Bank is conditional on its ability to exercise control over these principal forms of purchasing power. The Reserve Bank has been entrusted with considerable powers over them by statute.

The Bank, in the first place, has been entrusted with the monopoly of note issue, as well as with the holding of reserves against notes. The monopoly over note issue gives it absolute control over one of the principal media of payment, as well as of the cash basis for credit expansion. In order, however,

that the Bank itself may not pursue any unsound policy in issuing currency notes, provision has been made for the maintenance of adequate reserves against such notes. These requirements have been detailed in Part I. It will be noticed that they have been framed to subserve a twofold objective of preventing any inflationary process as well as ensuring a sufficient degree of elasticity. The Bank is also entrusted with the responsibility of maintaining the external value of the monetary unit.

In the second place, unlike the Bank of England, whose control over bank money has been a process of gradual development and is today effectively ensured through the efficient functioning of the discount market, the Reserve Bank has been endowed with certain statutory responsibilities for facilitating its control over the credit situation in the country. It is entrusted, first, with the duty of holding the cash balances of the commercial banks. Such a provision not only strengthens the financial position of a Central Bank, particularly a new one, but, what is of more importance, gives it also a useful means of control over the banking and credit situation. In respect of the function of legal reserve requirements, it is interesting to note that the committee on Bank Reserves of the Federal Reserve System observed[1] that 'the two main functions of legal requirements for member bank reserves under our present banking structure are, first, to operate in the direction of sound credit conditions by exerting an influence on the changes in the volume of bank credit, and, secondly, to provide the Federal Reserve Banks with sufficient resources to enable them to pursue an effective banking and credit policy'.

[1] See Report, p. 5.

The holding of Government balances, and the carrying out of the banking transactions of the Government also provide useful means to the Reserve Bank for exercising its influence over the credit situation.

There is, thirdly, section 18 of the Reserve Bank of India Act, which empowers the Bank to deal directly with the public under certain special conditions. This section says that when a special occasion has arisen, making it necessary or expedient that action should be taken for the purpose of regulating credit in the interests of Indian trade, commerce, industry and agriculture, the Reserve Bank may exercise the powers of direct discounts and advances, that is to say, it may deal with the public directly in the open market in accordance with the provisions of section 17, without the intermediation of a scheduled or a Provincial Co-operative Bank.

Effectiveness of Credit Control by a Central Bank

Before we examine the position of the Reserve Bank as the controller of credit in India, two general observations may be made on the ability of a Central Bank to control credit, irrespective of the particular purpose of control. In the first place, for this control to be fully effective, the Central Bank should be in a position to influence all forms of credit, including productive and trade credits. In so far as trade and other credits do not originate in bank credit, the regulating influence of the Central Bank would to that extent be limited, unless the dipensers of such credit were to accept the lead given by the Central Bank and act accordingly. Even in respect of bank credit, not all commercial banks may have direct dealings with the Central Bank. In India, for example, non-scheduled banks need maintain no cash reserves with the Reserve Bank, nor can they avail of the rediscounting and other facilities provided by it. In America, also, more

than half the number of commercial banks lies outside the Federal Reserve system. In the second place, the effectiveness of a Central Bank's control over credit depends upon the character of the money market in which it operates. In a well-organized money market, where its constituents are linked together through definitely related interest rates, and where commercial banks co-operate with the Central Bank, the control by the latter over bank credit is greatly facilitated and ensured. In an undeveloped money market, on the other hand, this control is comparatively difficult to achieve.

It is not necessary for our purpose to enter into a discussion of the comparative merits of alternative objectives of credit control. Whatever again may be the objective, its realization is well-nigh impossible without the co-operation of both the banks and the public. For, although it is possible to discriminate as between securities or bills offered for an advance or discount, no control can be exercised over the uses to which the proceeds thereof will be put.

Technique of Credit Control in an Organized Money Market

The classical means of control is the discount rate policy of a Central Bank, supplemented, if and when necessary, by open market operations. The discount or bank rate is the rate at which a Central Bank will discount bills of certain approved qualities, or make advances against certain defined securities. There are, however, certain assumptions for an effective functioning of a discount rate policy, even in an organized money market. In the first place, changes in the Central Bank's discount rate must bring about corresponding changes in the various market rates. In the second place, these changes, through their effects on the supply of and demand for money, as well as on the flow of short term capital, should be able to produce a readjustment in domestic prices

and costs.* The necessary conditions are thus a responsiveness of the money market to discount rate changes and a sufficient degree of elasticity in the economic structure. These conditions were present in a most satisfactory form in Great Britain before 1914, under the gold standard. A properly functioning gold standard is in fact most conducive to the effective working of a discount rate policy. Since the last War, and particularly since the Great Depression, the effectiveness of the discount rate policy has greatly suffered. For one thing, there have been very easy conditions in many money markets owing to the inflow of capital and gold or revaluation of gold or favourable balance of trade, etc. and public policy has favoured maintenance and continuation of comparatively liquid conditions. For another, an increasing rigidity in the economic structure of practically all countries has impeded the proper functioning of a discount rate policy. The decline in importance of the discount rate policy as a means of regulating credit has enhanced the significance and usefulness of open market operations for the same purpose. Open-market operations, in a wide sense, include the purchase or sale by the Central Bank in the market of any kind of paper in which it deals, such as Government securities, trade bills, bankers' acceptances, etc. In practice, however, the term is applied only to the purchase or sale of Government securities, whether long or short dated. Before the last Great War, open market operations were resorted to mostly as a supplementary measure, in case of need. Today they have assumed major significance and are often undertaken independently of any changes in the discount rate for the purpose of exercising control over the market.

In addition to discount rate policy and open market operations, a Central Bank has other weapons available to it for the control of credit, such as credit rationing, use of moral

suasion and publicity. Whatever may be the method of control, its effectiveness is largely conditioned by whether or not the market is well-organized and properly co-ordinated.

Unorganized Money Markets and Credit Control

The chief characteristic of an unorganized money market, such as India, is that there is no adequate organization for the mobilization of all surplus short-term funds in the market for the purpose of their effective utilization. The result is that these funds are not distributed among the various component parts of the money market in the most economical manner so that a situation of acute stringency in one sector may co-exist with easy conditions in another. The outward manifestation of this phenomenon is the absence of a co-ordinated relationship between the various interest rates.

A market such as this, which is not well-balanced and does not work on the basis of a narrow margin for the market as a whole, cannot be expected to be so easily or quickly responsive to changes in the credit situation or alterations in the discount rate as a well-developed market. Yet all Central Banks, including those in countries without properly organized money markets, use the discount rate as a weapon for regulating credit. Although this weapon cannot naturally be so effective nor be endowed with the same significance in an unorganized money market as in a well-developed market like the U.K. or the U.S.A., it nevertheless serves a very useful purpose even in unorganized markets. De Kock[1] mentions that the discount rate of such Central Banks has a three-fold significance. In the first place, the discount rate, particularly in countries where Central Banks have large dealings with the public, indicates the rate at which the

[1] De Kock: *Central Banking*, pp. 204–11.

latter can obtain accommodation from the Central Bank against certain specified securities. Central Banks, however, even when they possess large powers for dealing directly with the public, do not usually exercise this power and confine their activities mainly to dealings with commercial banks. Even under such conditions, the influence of the discount rate is exerted indirectly inasmuch as other credit institutions generally adapt their own rates to changes in the official discount rate. In the second place, the discount rate represents the basis of the rates at which commercial banks can obtain accommodation from the Central Bank. In the third place, the psychological value of the discount rate is of great importance to the Central Bank as an instrument of credit control. The degree of its importance evidently depends upon the prestige of the Central Bank and the co-operation it can obtain from the commercial banks. When this co-operation exists in large measure, a conventional relationship between the discount rate and other market rates may be gradually evolved.

To supplement a discount rate policy, open market operations may also be resorted to in the same way as is done in more developed money markets. But the scope for an open market policy is, in the case of many new Central Banks, limited as much by the relatively narrow markets for Government securities as by the restrictions imposed upon their powers of dealing in certain types of these securities. It is therefore quite understandable that many of these Banks have been assiduously encouraging the development of a Treasury Bill market.

The Reserve Bank and Control of Credit

In evaluating the rôle of the Reserve Bank as a controller of credit an obvious difficulty presents itself. Although the

bank has been in existence for about five years now, no serious occasion has yet arisen to test its hold over the market. Ever since its inception easy conditions have prevailed in the market and the necessity of invoking the aid of the Central Bank has not been felt by the market generally, which in India comprises mainly the commercial banks. It is noteworthy that up till now there have been no bills in the bank's portfolio other than Treasury Bills, which incidentally also bears testimony to the absence of a discount market in India, while 'other loans and advances', that is other than those given to Governments, have been insignificant. The examination of the Reserve Bank's rôle as a controller of credit has therefore to be confined largely to certain theoretical considerations, which, however, should not be considered to be devoid of practical significance or implications.

There are certain features of the Indian money market which might cast doubt on the ability of the Reserve Bank to exercise any effective control over credit. There is, in the first place, the pre-eminent position of the Imperial Bank in the money market. But, as we shall presently see, this position of the Imperial Bank need not detract, as in fact it has not, from the influence of the Reserve Bank as the custodian of the nation's financial interests. The Imperial Bank's peculiar standing in the market has evolved a novel procedure of control in India,—a procedure which may prove beneficial to both the Reserve Bank and the market.

In the second place, there is in the market a group of banks, called the Exchange Banks, which, if it should so elect, may frustrate a policy initiated by the Reserve Bank in view of its easy access to the London money market. The reality of this danger has also been referred to in Chapter V. But it is extremely unlikely that the Exchange Banks would take up an attitude, which would run counter to the intentions of

the Reserve Bank and also India's national interests. For, if they did, they would be creating a very delicate situation not only for the Reserve Bank but also for themselves and be further laying them open to the charge of acting contrary to national interests. Nor is there any great likelihood of a conflict developing between the Reserve Bank and the Exchange Banks. For a clash between them can arise only when the Reserve Bank intends to initiate a policy of restriction, which may not find favour with the Exchange Banks. But the initiation of a restrictive policy by the Reserve Bank is an unlikely event particularly in view of the unorganized condition of the Indian money market and also of the absence of conditions which would engender a speculative boom by means of bank credit or of considerations relevant to a country operating on the gold standard. In fact, the problem in India is to be interpreted more in terms of enlarging credit, when necessary, than of contracting it.

In the third place, it is suggested that in a country like India, where the money market is not organized, the Reserve Bank can wield but little influence. Neither the experience of this country nor of that of other undeveloped markets, however, supports this assumption. In South Africa [1], e.g., the Reserve Bank was of great use in helping the commercial banks to negotiate the difficult deflationary period following the last War. It was also of material use to the National Bank of South Africa in 1923 when that bank suffered a loss of capital and consequent impairment of its credit. The Commonwealth Bank of Australia [2] also rendered invaluable services in the difficult years from 1929 onwards. As the Canadian Banking and Currency Commission observes,

[1] *Report of the Canadian Banking and Currency Commission*, para 214.

[2] op. cit., para 216.

the Commonwealth Bank 'was instrumental in mobilizing the gold reserves of the country and their judicious employment with a view to tide the country over a period when Australia's ability to provide and to transfer the services of her overseas debt was seriously in question'.

In India, also, the Reserve Bank has provided sufficient evidence of its influence being felt in the market, although no occasion has yet presented itself to test the extent of its control over the market. The Reserve Bank has, further, another advantage which the Central Banks in South Africa or Australia did not enjoy. In both these countries the advent of central banking was viewed with considerable mistrust by the commercial banks. No such opposition existed in India to the idea of constituting a Reserve Bank, except probably only partially on the part of the Exchange Banks. Another advantage which has accrued to the Reserve Bank is the tradition, although in many respects imperfect, of central banking which the Imperial Bank had built up. In this tradition the rôle which the Imperial Bank discount rate played in its influence on other market rates deserves special mention.

As a positive evidence of the influence which the Reserve Bank has been able to exert in the money market may be mentioned the removal of seasonal stringency in the market, as demonstrated in a uniform bank rate throughout the year. This has in its turn had salutary effects on other market rates. Prior to the establishment of the Reserve Bank, not only were the various rates high and fluctuating, but there was also much divergence between them. With the Reserve Bank in operation, considerable improvement has been effected in both these aspects, as the following figures will testify:

	Bank rate	Imperial Bank Hundi rate	Calcutta Bazaar rate	Bombay Bazaar rate
September 1929[1] ..	5	5	11	6
March 1930[2] ..	7	7	11	$9\frac{1}{16}$
September 1939 ..	3	3	6-7	6
March 1940 ..	3	$3\frac{1}{2}$	6-7	$6\frac{3}{4}$

The table reveals not only a welcome reduction absolutely in all rates, but also a narrowing down of the divergences between them. A noteworthy feature is the absence of any great disparity now between the Bombay and Calcutta bazaar rates. This phenomenon may be interpreted as an indication of more intimate and organic contact between the two markets, which presumably the establishment of the Reserve Bank has facilitated.

Another salutary effect of the establishment of the Reserve Bank has been the impetus it has provided to the development of sound banking practices. In fact it is one of its statutory obligations to foster the development of banking on sound lines. Its services in this connexion will not only improve banking standards, but also extend the scope of its control over the market.

The Reserve Bank has also been trying to develop a wider market in Treasury Bills, which, if it is accorded larger support by commercial banks, would facilitate its control over the latter.

Reserve Bank's Methods of Control

Although the Reserve Bank has not as yet had any occasion to embark upon an active policy in the money market for the purpose of regulating credit, there can be no doubt that it exercises considerable influence over the market and is well

[1] & [2] Imperial Bank Discount rate.

placed to serve this purpose. The effectiveness of its function as a controller of credit will, however, be materially conditioned by the methods available to it to exercise this control. The most important weapons are undoubtedly the manipulation of the discount rate and open market operations. These and the other weapons available to the Reserve Bank for regulating credit will be examined in the following chapter.

The Reserve Bank and the Imperial Bank

In Chapter IV, the unique position of the Imperial Bank in the Indian money market has been described and reference has also been made to its position as a buffer between the Reserve Bank and the money market. How much more intimately the Imperial Bank is associated with the money market than the Reserve Bank will be borne out by the following figures for December, 1940:

	In lakhs of rupees
IMPERIAL BANK OF INDIA	
Cash Credit and Overdrafts ..	21,14
Bills discounted and Purchased ..	3,82
RESERVE BANK OF INDIA	
Bills Purchased and discounted ..	nil
(a) Internal	nil
(b) External	nil
(c) Treasury Bills	nil
Other Loans and Advances ..	5

The Imperial Bank's figures refer to both banks and its other clients. But since the Reserve Bank's bill portfolio, with the exception sometimes of Treasury Bills, is nil and its 'other loans and advances' negligible, there can be no doubt that the larger commercial banks in distress approach the Imperial Bank for accommodation, while the smaller ones often obtain assistance from their larger confrères.

The question naturally arises as to whether this unique position of the Imperial Bank constitutes any threat to the proper and efficient functioning of the Reserve Bank. Fortunately there appears to be no ground for the materialization of this danger. The relations between the two banks have been perfectly cordial, and there has been a realistic appreciation of the relative functions of the two banks in the Indian money market. If the Reserve Bank is the manufacturer of emergency credit in times of stress, the Imperial Bank will function largely as a wholesaler for its distribution to commercial banks, which again will retail them to the public. The scheduled banks can, of course, directly approach the Reserve Bank for accommodation. But there are two considerations which might incline them to prefer the Imperial Bank. In the first place there is a long-standing relationship subsisting between the Imperial Bank, on the one hand, and the scheduled and other commercial banks, on the other. In the second place, the basis for obtaining accommodation from the Reserve Bank is narrow and strict. The Imperial Bank is not so much hampered as is the Reserve Bank by statutory provisions. When it is satisfied about the credit and standing of the borrowing bank, the Imperial Bank is in a position to extend credit more liberally.

The Reserve Bank and the Bazaar Market

The question of the effectiveness of the Reserve Bank's control over the money market has, for obvious reasons, been confined so far to its organized section. In fact, the Reserve Bank cannot exercise any influence directly over the credit situation in the bazaar market. Unless indigenous bankers and money-lenders reorganize their business methods, the Reserve Bank will not be in a position to offer them any

assistance. But the absence of any powers for direct influence does not mean that the Reserve Bank exercises absolutely no control over the bazaar market. It is well known that operators in the bazaar market have often to approach the Imperial Bank and other commercial banks for discounting their bills or for advances against approved securities. In so far as they are forced by conditions in their own market to seek assistance of institutions in the organized money market, they expose themselves, albeit indirectly, to the regulating influence of the Reserve Bank. Further, a closer correspondence in recent years between their rates and the Imperial Bank Hundi rate is a welcome indication of a gradual development of a more organic relationship between the two markets, and as such to a widening of the scope of influence of the Reserve Bank.

CHAPTER X

THE RESERVE BANK AS CONTROLLER OF CREDIT

(Continued)

WE shall now examine the various methods which the Reserve Bank can use to regulate credit. Of these methods the two most important are the manipulation of discount rate and open market operations.

The Discount Rate

The effectiveness of the discount rate is to be judged not only by its level but also by the papers which are considered eligible by the Reserve Bank for purposes of rediscounting and lending and by the relative importance of these papers in the money market. We shall take up the second aspect first.

It should be noted that the power of discounting bills and making advances which the Reserve Bank enjoys as a Central Bank has a two-fold significance. In the first place, it is used for regulating credit. In the second place, this power of extending credit is limited to dealing in certain specified types of bills and securities. In this aspect, it represents the nature of assistance which scheduled banks may expect from the Reserve Bank in times of difficulty. In a letter [1] which the Reserve Bank circulated to the scheduled banks, it defined the functions of a Central Bank as of a two-fold character. The first function is to pool the resources of the banks and use them for the regulation of the general credit policy of the

[1] The substance of this letter has been incorporated in Chapter IV of the book entitled *Functions and Working of the Reserve Bank of India*, published by the Reserve Bank of India in 1941.

country so that the Bank may render effective assistance at times when the resources of member banks are depleted. The Bank's second responsibility is to assist, under certain conditions, individual member banks in difficulty. It will be observed that the second function is implicit in the first, viz., that an examination of the basis of control also reveals the nature of assistance which member banks may obtain from the Reserve Bank. It may be added that the question of assistance which member banks may expect from the Reserve Bank assumed particular importance during the crisis of the Travancore National and Quilon Bank, which ultimately failed to meet its obligations. In the uncertain and anxious atmosphere which the failure of this bank generated, the Reserve Bank, with a view particularly to allay public criticism, clarified its position in the market *vis-à-vis* the scheduled banks. Thus, in examining the nature of paper eligible for rediscount or advances by the Reserve Bank, we shall also be studying the nature of help which institutions entitled to avail of the services of the Reserve Bank may expect from it in times of their difficulty.

Nature of Reserve Bank Advances

The nature of advances of the Reserve Bank to scheduled banks is detailed in section 17 of the Act. These advances may be classified under two broad sections:

(*a*) On paper eligible for rediscount by the Reserve Bank, and

(*b*) Other advances.

A. Papers eligible for rediscount

These papers are:

(*a*) Bills of exchange and promissory notes drawn on India or Burma and payable in India or Burma. Section

17(2)(*a*) of the Act authorizes the Reserve Bank to 'purchase, sell, rediscount bills of exchange and promissory notes, drawn on India or Burma, and payable in India or Burma and arising out of *bona fide* commercial or trade transactions bearing two or more good signatures one of which shall be that of a scheduled bank and maturing within ninety days from the date of such purchase or rediscount'. The Reserve Bank is, therefore, in a position to discount for any scheduled bank any promissory note or bill of exchange which satisfies the following conditions:

(i) it arises out of *bona fide* trade or commercial transactions. This means, to quote from the Reserve Bank circular, that it must be a bill drawn for financing the movement or marketing of goods or produce, and not a bill of exchange or a promissory note, the proceeds of which are to be used for fixed or permanent investments or for speculative purposes;

(ii) it bears two or more good signatures, one of which is that of a scheduled bank;

(iii) it has a fixed maturity not exceeding ninety days, without days of grace, from the date of purchase or rediscount by the bank. A demand promissory note or a bill of exchange alone does not constitute eligible paper inasmuch as these instruments have no fixed maturity.

(*b*) Agricultural Paper: The conditions which an eligible agricultural paper has to satisfy are detailed in Section 17(2)(*b*) of the Act and are as follows:

(i) it must be drawn and payable in India or Burma;

(ii) it must be drawn or issued for the financing of seasonal agricultural operations or the marketing of crops;

(iii) it must mature within nine months from the date of purchase or rediscount by the Reserve Bank;

(iv) it must bear two or more good signatures, one of which must be that of a Provincial Co-operative Bank or a scheduled bank.

(*c*) Bills of Exchange or Promissory Notes drawn for the purpose of holding or trading in Government securities. This provision is on the same lines as in (*a*) above, and is defined in Section 17(2)(*c*) of the Act, with this exception that the purpose underlying this section is the facilitation of the holding or trading in Government securities, while under Section 17(2)(*a*) the bills should subserve *bona fide* trade or commercial purposes.

This sub-section was evidently designed for the purpose of developing a bill market which would finance dealing in Government securities. In the absence of such a bill market, however, this sub-section has in practice remained inoperative.

(*d*) Bills of Exchange drawn in or on a place in the United Kingdom. Section 17(3)(*b*) authorizes the Reserve Bank to deal in such bills including Treasury Bills of a maturity not exceeding ninety days, but only through the intermediary of a scheduled bank.

B. Other Advances of the Reserve Bank

(*a*) Advances on Trustee Securities. Section 17(4)(*a*) authorizes the Reserve Bank to make loans and advances to scheduled banks, repayable on demand or on the expiry of fixed periods not exceeding ninety days, against what are known as trustee securities, with the exception of immovable property. The Reserve Bank underlines that these securities must be readily marketable, and whether they are so is a question which the Reserve Bank will decide in each particular case. For the present the Reserve Bank limits its advances

under this sub-section only to loans repayable on demand, but it is stated that it will in course of time be prepared to make loans for fixed periods of time not exceeding ninety days.

(*b*) Advances against bullion. Section 17(4)(*b*) empowers the Reserve Bank to make loans and advances to scheduled banks, repayable on demand or for fixed periods not exceeding ninety days, against the security of gold or silver, or documents of title to the same. The margin that the Reserve Bank will demand for advances under this sub-section can be ascertained from it from time to time. Gold or documents of title offered by a scheduled bank as security must be such over which it has a full title, and is thus in a position to convey to the Reserve Bank a full legal title to the same. Thus, a scheduled bank cannot offer as security to the Reserve Bank gold pledged to it by its customer.

(*c*) Advances on Bills of Exchange or Promissory Notes. Section 17(4)(*c*) empowers the Reserve Bank to grant loans or advances to scheduled banks, repayable on demand or on the expiry of fixed periods not exceeding ninety days against the security of such bills of exchange and promissory notes as are eligible for purchase or rediscount by the Reserve Bank.

(*d*) Advances against Promissory Notes supported by documents of title to goods. Section 17(4)(*d*) authorizes the Reserve Bank to make to scheduled banks loans and advances repayable on demand or on the expiry of fixed periods not exceeding ninety days, against the security of promissory notes of any scheduled or Provincial Co-operative Bank, supported by documents of title to goods, which have been transferred, assigned or pledged to any such bank as security for a cash credit or overdraft granted for *bona fide* commercial or trade transactions, or for the purpose of financing seasonal

agricultural operations or the marketing of crops. Two observations are called for in respect of this sub-section. In the first place, the word 'which' in this sub-section appearing after the words 'documents of title to goods', refers to such documents only and not to goods themselves. It follows therefore that the scheduled bank must also have advanced money to its customer against documents of title to goods and not against goods themselves, if it intends to pass this paper to the Reserve Bank for obtaining accommodation from the latter. For, if the goods were pledged directly to a scheduled bank by its customer, then the scheduled bank would have itself to create the document of title and this it cannot do, inasmuch as though it is in possession of the goods of its customer, it cannot be considered his mercantile agent as defined in the Indian Sale of Goods Act. In the second place, it should be noted that the cash credit or overdraft referred to in the sub-section shall have been granted only for *bona fide* trade or commercial transactions or for the purpose of financing seasonal agricultural operations or the marketing of crops.

Lending Policy of the Reserve Bank

Although the Reserve Bank is empowered to provide credit against the securities mentioned above, it does not follow that it is obliged to lend whenever any kind of eligible paper is brought to it. In fact the Reserve Bank observes in its circular, that in extending credit to scheduled banks, it will be influenced not merely by the nature of security offered, but also by other considerations such as the general character of the investments of the applying bank, the manner in which its business as a whole is conducted, whether, for example, it attracts deposits by offering excessively high rates of interest, whether it seeks help from the Reserve Bank in normal

times when funds in the market are ample, whether it has been overtrading and extending an undue amount of credit for speculative purposes in commodities or securities or indulging in unsecured business to an excessive extent. These considerations are, however, common to central banking operations in all countries, and are essential for ensuring that banking development will proceed along sound lines.

Adequacy of the Lending Policy of the Reserve Bank

In the absence of a suitable opportunity for subjecting the lending and rediscounting facilities offered by the Reserve Bank to a real test, it is not possible to express any definite opinion upon their adequacy. In view of the lack of a sufficient volume of such internal commercial bills as may rank as eligible paper, the rediscounting facilities of the Reserve Bank are not likely to be of much value to most scheduled banks. As regards advances, the absence of warehouses restricts the scope of accommodation that may be obtained by scheduled banks against the security of promissory notes supported by documents of title to goods. By far the most useful method of obtaining accommodation, which scheduled banks can avail of, is against the security of trustee securities, excepting immovable property. It is, therefore, a moot question whether the definition of eligible paper will not, in practice, be found to be too restrictive. It may be mentioned that this difficulty was experienced in an acute form in South Africa, and led to a widening of the scope of the definition of eligible paper. In 1930, the South African Reserve Bank was empowered[1], in addition to its original powers, to make advances against long-dated Government and Municipal securities, one-name bills or promissory

[1] De Kock: *Central Banking*, p. 116.

notes, secured by documents of title representing staple commodities, and non-speculative dividend or interest-bearing securities, having a ready sale on the stock exchange. Further, the maturity of commercial paper eligible for discount was extended from 90 to 120 days.

There is, however, one special trait of the Indian money market which may render any extension of the scope of eligible paper unnecessary. This special trait is represented by the position of the Imperial Bank. It has been already mentioned that most commercial banks are likely to approach the Imperial Bank in the first instance for accommodation. The Imperial Bank is not so much shackled by restrictions as is the Reserve Bank. In these circumstances the narrow definition of the Reserve Bank's eligible paper need not occasion any serious hardship to scheduled banks, nor impair the influence of the Reserve Bank over the market.

Level of the Bank Rate

In respect of the level of the bank rate itself, it is sometimes contended that in view of wide disparities in market conditions in different parts of India a uniform bank rate is likely to be a weapon of doubtful effectiveness. There is much truth in this contention. Yet it should not be forgotten that considerable improvement is already noticeable in the inter-relationship of the different important money markets in India, particularly Calcutta and Bombay. The different money rates obtaining in these two centres and their closer correspondence in recent years bear witness to this. The extension of branch banking should also have assisted this process of improvement. The policy of the Reserve Bank, therefore, to charge a uniform rate throughout the country is to be commended for results already achieved, and its continuance

should further ensure the growth of a more organic relationship between the important money markets.

Open Market Operations

To supplement its discount rate policy, or even as an independent weapon to subserve particular ends, the Reserve Bank can influence credit conditions in the market by undertaking open market operations. This weapon operates by enlarging or contracting the cash basis of the commercial banks as a result of the purchase or sale by the Bank of Government securities. The effectiveness of this method depends largely upon the scope of the securities in which the Bank is entitled to operate as well as the nature and organization of the market in which these operations are undertaken.

The nature of the securities in which the Reserve Bank can deal is specified in Sections 17(7) and 17(8) of the Act. Section 17(7) of the Act authorizes the bank to purchase and sell Government securities of the United Kingdom maturing within ten years from the date of purchase. Section 17(8) lays no restriction in respect of maturity only of the securities of the Government of India, or a Local Government or of such securities of a local authority in British India or of Indian States, which may be specified by the Governor-General in Council on the recommendation of the Central Bank. which the Bank may purchase or sell. But the sub-section contains a condition that such securities held at any time in the banking department shall be so regulated that (*a*) their total value shall not exceed the aggregate amount of the share capital of the bank, the Reserve Fund, and 3/5ths of the deposit liabilities of the banking department; (*b*) the total value of securities maturing after one year shall not exceed the aggregate amount of the share

capital of the bank and the Reserve Fund and 2/5ths of the deposit liabilities; and (*c*) the total value of securities maturing after ten years shall not exceed the aggregate amount of the share capital of the bank and the Reserve Fund and 1/5th of the deposit liabilities of the banking department.

The purpose of many of these restrictions is obvious. It is to confine the operations of the Bank mainly to short-dated securities, so that it may suffer no loss in point of liquidity nor in value as a result of fluctuation in prices. This restriction to dealings mainly in short-term securities constitutes a limitation on the possible scope of open market operations by discrimination against dealings in long-dated securities. Large-scale open market operations are, however, possible only in centres with broad and active markets in both long-term and short-term Government securities. But only London and New York, and more particularly the former, satisfactorily comply with this condition.

As to the nature and organization of the market from the point of view of its responsiveness to operations undertaken by the Reserve Bank, it is difficult to express an opinion in the absence of knowledge of the result of actual operations. It would appear, however, that the Reserve Bank has resorted to these operations with satisfactory results, although probably not for the purpose of regulating credit. In an article contributed by Mr (now Sir) Nanavati, Deputy Governor of the Reserve Bank, to the Bombay Investors' Year Book, 1940[1], the following interesting observation is made: 'This power (of open market operations) is specially useful during war time when prices of securities are subject to sharp fluctuations'. Although Mr Nanavati does not specially say that the Reserve Bank undertook open market operations with a view

[1] Published by Devkaran Nanjee, p. 27.

to support the security market, there is a presumption in favour of this assumption, particularly in view of the comparatively stable prices of Government securities after the earlier shocks were tided over.

It may also be recalled that the Reserve Bank is anxious to widen the market for Treasury Bills, although up till now only a few big scheduled banks in the market, of which the Imperial Bank is the most important, render any active assistance to the Reserve Bank in this matter.

Other Weapons

In addition to the two important weapons already mentioned, the Reserve Bank, it may be recalled, has also been entrusted with the authority to deal directly with the public in kinds of paper which are deemed 'eligible', but only under certain special conditions. This provision invests the Reserve Bank with special power of considerable potency to force the commercial banks to follow particular policies initiated by it. It is, however, extremely unlikely that this power will be used or even need be used, for the very fact that the power exists should be a sufficient warning to commercial banks not easily to run counter to the wishes of the Reserve Bank.

Of the other instruments of control generally available to a Central Bank, those relating to the rationing of credit to and the taking of 'direct' action against 'scheduled' or member banks are as yet of little practical value in India, inasmuch as these banks are not large borrowers of Central Bank credit. Publicity has been used as a fruitful weapon only in America. Its scope in India for controlling credit of member banks by making representation to the institutions concerned must obviously be very restricted. The reason therefor is that these banks do not yet use central banking

credit to any appreciable extent. But moral suasion, in the sense of effecting an improvement in banking standards and practices as a result of representation or instructions offered by the Reserve Bank, can be, and has indeed been, of considerable practical effect.

Another method of control of an indirect nature may be fruitfully used in India. It is the growth of a healthy convention between the Reserve Bank and other important constituents of the money market. Its practical manifestation is seen in the relationship subsisting between the bank rate and other money rates in the market, in which the latter rates follow the lead given by the former. The Imperial Bank had, prior to the establishment of the Reserve Bank, developed a sort of a convention of this nature, which the Reserve Bank should be in a position to render more effective. In a country, however, like India, where the bank rate is not usually a penalty rate but serves rather as an indication of general credit conditions, so that it may not be lower, but may even be higher, than the rate charged by commercial banks, it is probably necessary for central banking control to be effective that a rise in official rates should precede the rise in market rates and a fall in official rate should anticipate reductions in market rates.

CHAPTER XI

RESOURCES OF THE ORGANIZED MONEY MARKET

A MONEY market as a mechanism, through which only short-term funds are loaned and borrowed and which deals only in certain types of more or less standardized businesses such as call loans, acceptances and Treasury Bills, in which the personal relationship between lender and borrower is of negligible importance, exists in Calcutta or for that matter in any other money market in India, only in a very limited form. This undeveloped state of Indian money markets is mainly due to the absence of a discount market, which in all developed financial centres occupies the key position in, and functions as a shock-absorber of, the market. The lack of a discount market which detracts from the efficient functioning of the Indian money markets, also characterizes in varying degrees many undeveloped European money markets, and even the Paris market. It is, therefore, probably not presumptuous to speak of the Calcutta or the Bombay money market even in a narrow sense. In a broader sense, as including the collateral loan market, the money markets in India assume a more real significance.

Comparison with other countries

A money market, in its most developed state, exists only in London. To such extent is this true that in one sense, viz., when 'bill-brokers and discount houses adjust the supply and demand of money and of bills, the money market and the discount market coincide'[1]. In New York, although accep-

[1] Truptil: *British Banks and the London Money Market*, p. 235.

tance business has been increasing, short-term fund is lent more against securities than against bills, and does not, therefore, possess that measure of self-liquidating character which a bill portfolio together with a discount market ensures. Paris had uptill 1935 practically no discount houses, and bankers' acceptances are still not much in favour. The difference between the London and the Paris money markets is revealed in the categories of funds invested in the two money markets. In London, the items are (*a*) cash in hand and at the Bank of England, (*b*) funds lent at call and short notice, and (*c*) the bill portfolios of banks. Of these items, that relating to funds lent at call or short notice to the discount market and the stock exchange or the short loan fund is by far the most important. Its movements in effect reveal the pulse of the money market. The funds with which the Paris money market in the narrow sense is concerned are (*a*) cash in hand and at the Central Bank, and (*b*) funds invested in bills only. The state of Indian money markets bears resemblance to the condition of the Paris market.

The absence of a developed discount market in India invests its money markets with certain traits. In the first place, the absence of personal relationship, which should characterize dealings in the money market, is lacking. As in Paris, transactions in the money market are largely influenced by personal relations between borrowers and lenders, who are mostly bankers. With the result that uniformity of rates, which distinguishes a very large bulk of loans in the London markets is lacking in India, although it should not be presumed that in India there are very wide fluctuations in rates charged to different borrowers. In the second place, as there is no reservoir in the Indian markets for surplus funds to flow into for investment in highly liquid assets, banks depend for the most part upon their

own resources, and are, therefore, not so easily or speedily amenable to the influence of the Central Bank.

It is interesting to observe that there is a more developed discount market in the bazaar section of the Indian money market than in its organized counterpart. We shall have occasion to refer to this later on.

Resources of Banks in Calcutta

The funds lent in the organized section of the Calcutta money market are provided almost wholly by banks. There are no acceptance or discount houses or bill brokers as in London to add to the funds supplied by banks. To obtain an idea of the resources of the Calcutta money market we might start with an attempt at estimating the resources of banks in Calcutta, and then try to set out what proportion of these resources is employed in the Calcutta market both in the narrow and in the broad sense.

Difficulties of Statistical Estimate

The almost insuperable difficulty of any statistical estimate, either of the resources of banks or of the money market, is evident to anybody who undertakes it. No statistics are published of resources of individual markets. From the published balance sheets of banks which operate over wide areas in the country, it is difficult to say what proportion of their funds is attracted from and employed in particular markets. Banks do not furnish this information and the Reserve Bank does not publish it. Yet an estimate, however tentative, of the banks' resources in Calcutta is necessary for a proper appreciation of the magnitude and importance of Calcutta as a money market.

The resources of banks are composed of their capital, reserves and deposits. The first task is to make an estimate

of the deposit liabilities in the Calcutta money market of banks operating therein. As these banks include the Imperial Bank, the Exchange Banks and the big five Indian banks, which also operate in other financial centres of India including Bombay, their deposit liabilities in the Calcutta money market are not easy of assessment. Further, the relative importance of these different types of banks is not the same in different money markets in India, so that no single criterion can be formulated to estimate the proportion of their total Indian deposit liabilities, contributed only by Calcutta, or say Bengal, Assam, Bihar and Orissa, which come under the orbit of the Calcutta money market. For example, the Exchange Banks are important primarily in Bombay and Calcutta, while the Bank of India, and particularly the Central Bank of India, gather their funds from many more centres. The Clearing House figures do not provide any correct indication of the funds of banks invested in various centres. For one thing, Clearing Houses exist only in a few centres. For another, allowance has to be made in our computation for the number of centres in which particular banks operate. In the estimates provided here, reliance has been placed primarily on enquiries made in the market and checked from various sources. In fact, it is not difficult to obtain some rough idea of the relative importance as well as of the resources and operations of the important banks in the Calcutta money market.

Estimate of Bank Deposits in the Calcutta Money Market

An estimate of the deposits of the scheduled banks may be considered sufficient for our purpose. Not only are the funds of the non-scheduled banks comparatively insignificant, but their influence on the money market, particularly in the narrow sense, is very small.

It is convenient to classify the scheduled banks under the following categories: (*a*) Imperial Bank, (*b*) Exchange Banks, (*c*) Non-Bengali Scheduled Banks, (*d*) Bengali Scheduled Banks. All figures have been compiled from the December 1940 balance sheets of the banks.

Imperial Bank

The total deposits of the Imperial Bank on 31-12-40 amounted to Rs96,03 lakhs. From a statement[1] submitted by Mr Norman Murray to the Hilton-Young Commission it is found that the distribution of the bank's deposits as on 31-3-1925 between Bengal, Bombay and Madras circles was in the proportion of 53, 27 and 20 per cent respectively. The Clearing House returns for 1940-41 reveal that the value of cheques cleared through Calcutta, Bombay and other centres is in proportion of 47, 37 and 16 per cent respectively. If we take the mean of these two ratios, Imperial Bank deposits in the Bengal circle would amount to about 50 per cent of its total deposits or roughly Rs48 crores.

Exchange Banks

The total Indian deposits of Exchange Banks for December, 1940, amount to about Rs86 crores. As the Exchange Banks operate mainly in Calcutta, Bombay, and Madras, and as Calcutta is relatively more important than Bombay in so far as the business of these banks is concerned, it may be assumed that the proportions of deposits in these centres would be in the ratio of 50 : 40 : 10 respectively. On this basis, the deposits of Exchange Banks in Calcutta would be about Rs43 crores.

Non-Bengali Scheduled Banks

Of these banks, the most important are the big Indian five. An assessment of their deposits in Bengal is difficult.

[1] Appendix 48, *The Hilton-Young Commission Report*, Vol. II.

But an intelligent study of the conditions in the market as well as corroborative enquiries suggests that in respect of the Central Bank of India and the Bank of India, Bengal deposits would be about 25 per cent of their total deposits, the proportion for the Bank of India being probably a little smaller. The Allahabad Bank operates in Bengal, the U.P. and the Punjab, and its deposits in Calcutta will be about 35 per cent of its total deposits. The Punjab National Bank and the Bank of Baroda would between them be responsible for a deposit liability of about Rs1 or 1½ crores in Calcutta. The approximate Bengal deposits of the five big banks are as follows:—

	Rs
Central Bank of India	9 crores
Bank of India	4 ,,
Allahabad Bank	4 ,,
Punjab National Bank and Bank of Baroda	1 ,,
TOTAL	18 crores

The other scheduled non-Bengali banks in Calcutta are the Bank of Bihar and the Jwala Bank and their deposits would be a few lakhs of rupees only.

Bengali Scheduled Banks

The deposits of the five big Bengali banks as on 30-12-40 are as follows:

	Rs
Bengal Central Bank	1,07 lakhs
Bhowanipore Banking Corporation [1]	93 ,,
Comilla Banking Corporation	1,50 ,,
Comilla Union Bank [2]	2,07 ,,
Nath Bank	1,35 ,,
	6,92 ,,
	= about 7 crores.

[1] Not a scheduled bank.

[2] Figures are for 13-4-41.

The other scheduled Bengali banks are the New Standard Bank, the Calcutta National Bank, the Karnani Industrial Bank, the Calcutta Commercial Bank, the Mohaluxmi Bank, the Noakhali Union Bank and the Dinajpore Bank. The total deposits of all these banks amount on 30-12-40 to about Rs1½ crores. Some of the Bengali scheduled banks have also branches outside Bengal, but as their total deposits at these outside centres is not likely to be more than about 25 lakhs, the total deposits of Bengali scheduled banks in the Calcutta market would amount to between Rs7 and 7½ crores.

To obtain an estimate of the total resources of the scheduled banks in Calcutta, we must also add the capital and reserves of those banks whose head offices are in Bengal. As the principal office of the Imperial Bank is in Calcutta, the capital and reserves of this bank may be included in the resources of the scheduled banks in Calcutta. The total of these resources will, therefore, be as follows:

In crores of rupees

	Capital and Reserves	Deposits	Total
Imperial Bank	11	46	57
Exchange Banks	..	43	43
Non-Bengali Scheduled Banks ..	..	18	18
Bengali Scheduled Banks ..	·90	7	7·90
	11 90	114	125·90

The total resources of the scheduled banks in the Calcutta money market would thus amount to about Rs126 crores. If an allowance of about Rs5 to 6 crores were made for balances of banks with each other as well as with the Imperial Bank in the total deposit liabilities, the total deposits of scheduled banks in Calcutta would be slightly under Rs110 crores and the total of their resources about Rs120 crores.

Resources of the Organized Money Market

We have roughly estimated the resources of scheduled banks in Calcutta. An attempt may now be made to estimate the resources of the Calcutta money market both in a narrow and a broad sense. In the absence of relevant information, this estimate can also be nothing but very tentative. In the narrow sense the funds of the money market will include only cash in hand and with banks, money at call and bills discounted and purchased. In the broad sense collateral loans will also be included such as loans, advances and cash credits. In estimating these items of the non-Bengali scheduled banks as well as of the Imperial Bank in the Calcutta market, an assumption has been made that they bear the same proportion in Calcutta to Calcutta deposits as their respective totals bear to total deposits of the banks concerned. As the Punjab National Bank does not show in its balance sheet the amount of bills discounted and purchased separately, the amount of this item could not be obtained for this bank in Calcutta, although it is known that it deals fairly extensively in bills. The Bank of Baroda in Calcutta does not deal much in bills. The Bengali banks, with the exception of the Comilla Union Bank, do not show their bill portfolio separately. It has not, therefore, been possible to show separately their holdings in bills. It is also not possible to find out the bill portfolio of the Exchange Banks. In fact no information about their investments is available. On the basis of the statement submitted by the Exchange Banks to the Indian Central Banking Enquiry Committee in respect of their investments for 31st December, 1929, it would appear that over 80 per cent of their deposits were invested in short-term funds, although it was not made clear what proportion of this amount was invested in bills. On this basis, of about

Rs43 crores of deposits of the Exchange Banks in Calcutta in December, 1940, something between Rs34 and 35 crores should have been invested in the short-term money market in a broad sense.

The resources of the Calcutta money market as on 31-12-40 and as provided by the scheduled banks may be classified under the following heads:

In lakhs of rupees

	Cash and balance with bank and money at call	Bills discounted and purchased	Loans advances and cash credits
Imperial Bank of India ..	12,41	1,91	14,24
Central Bank of India ..	2,25	50	3,29
Bank of India	1,10	5	1,35
Allahabad Bank	77	10	1,77
Punjab National Bank and Bank of Baroda	15	..	50
The big five Bengali banks ..	1,76	7	3,54
Other scheduled Bengali banks ..	48	..	85
Exchange Banks	..		35,00
TOTAL ..	18,92	2,63	60,54

Thus, the resources of the Calcutta money market as contributed by the scheduled banks amount roughly to Rs22 crores in a narrow sense and to Rs82 crores in a broad sense. On an allowance being made for the fact that balances of many banks with each other, and particularly with the Imperial Bank, have also been included in the deposits of the banks, we may say that these resources of the money market amount to a little over Rs16 crores in a narrow sense, excluding the bill portfolio of the Exchange Banks, and to about Rs77 crores in a broad sense. The last item in the table, however, includes in all probability some long-

term loans or advances made by these banks, particularly by the Bengali banks. On an assumption that such loans would amount to 5 per cent of the loans and advances of non-Bengali banks, and of between 15 to 20 per cent of the loans and advances of Bengali banks, about 2 crores would be accounted for by long-term loans or advances, that is loans or advances allowed against real estate or block capital. Deducting this amount from Rs77 crores, the resources in a broad sense of the Calcutta money market contributed by the scheduled banks would amount roughly to Rs75 crores.

Non-Scheduled Banks and the Money Market

In these estimates of the resources of banks and the money market, account has been taken only of the scheduled banks on the assumption that non-scheduled banks exert, comparatively speaking, but little influence in the money market. Yet, it will be of interest to have some idea of the total funds of the non-scheduled banks as well as of the amount invested in the short-term money market.

There are in Calcutta numerous small banks. The Metropolitan Banking Association has, for example, over fifty members; and there are a few other banks which are not its members. Some of these banks are so small that their influence in the market is virtually nil. Further, it is extremely difficult to obtain the balance sheets of many of the smaller banks. Under the circumstances, only such non-scheduled banks have been included in the preparation of the estimates given below as have a paid-up capital and reserve of Rs50,000 or over. The relevent particulars, together with the names of the banks are provided in the accompanying table. All figures relate to the 1940 balance sheets of the banks concerned, or, in their absence, the latest available balance sheets.

	Name of Bank		Year ending	Paid-up capital	Reserve	Deposits	Cash and balance with bank and money at call	Bills discounted and purchased	Cash credit, loans and advances
				In thousands of rupees					
1.	Abhoya Bank ..	..	31-12-40	20	1,16	6,13	53	..	3,98
2.	Bank of Commerce	..	31-12-39	64	7	10,41	82	..	8,03
3.	Bengal Bank ..	..	31-12-40	1,49	11	10,65	1,98	..	9,81
4.	Berhampore Bank ..	..	31-12-40	38	21	11,54	1,65	..	7,12
5.	Central Calcutta Bank	..	30-6-40	82	5	8,09	1,78	8	6,45
6.	City Commercial Bank	..	31-12-39	60	..	1,34	1,14	.	52
7.	Comrade Bank ..	..	31-12-39	57	7	2,42	46	7	2,04
8.	Continental Bank of Asia	..	31-12-39	57	1	4,65	2,25	..	3,10
9.	Dass Bank ..	..	30-6-40	5,08	..	92	2,12	..	3,05
10.	East Bengal Bank .	..	14-4-40	1,69	49	11,29	87	12	12,26
11.	Eastern National Bank	..	31-12-40	5,14	9	5,13	1,42	14	6,25
12.	Eastern Union Bank	..	31-12-40	74	31	3,84	69	..	3,83
13.	Girish Bank ..	..	30-6-40	1,15	15	3,15	40	26	2,82
14.	Hooghly Bank ..	..	31-12-40	1,82	81	36,13	5,71	3,14	21,94
15.	Laxmi Industrial Bank	..	31-12-40	1,05	30	16,37	3,13	46	6,58
16.	Morris & Morris ..	..	31-12-40	5,00	3	2,29	27	22	1,27
17.	National Security Bank	..	31-12-40	5,22	10	3,03	85	..	2,44
18.	New Bengal Bank ..	..	30-6-39	70	8	2,44	55	18	2,23
19.	Overland Bank ..	..	31-12-40	6,04	98	2,16	99	85	7,78
20.	Pacific Bank ..	..	31-12-40	6,86	1	10,95	2,46	11	6,84
21.	Reliance Bank ..	..	13-4-40	1,01	50	3,87	81	..	3,70
22.	Southern Bank ..	..	30-6-40	74	5	8,69	2,46	..	5,88
23.	Standard Bank ..	..	31-12-39	1,28	1	10,68	4,11	..	3,82
24.	Sylhet Industrial Bank	..	13-4-40	1,74	13	20,73	3,90	24	16,11
25.	Tripura Modern Bank	..	13-4-40	1,90	39	14,35	4,65	7	11,05
	TOTAL	..	..	52,43	6,11	211,25	46,00	5,94	158,90

It will appear from the table that the total funds of the 25 non-scheduled banks having a paid-up capital and reserve of Rs50,000 or over amount to about Rs2,70 lakhs. The amount contributed by them to the resources of the money market is a little over Rs50 lakhs in a narrow sense, and roughly Rs2,10 lakhs in a broad sense. If we assume that about 25 per cent of the loans and advances of these non-scheduled banks are strictly speaking not advances to the money market as such, the amount of loans and advances invested in the money market will amount to about Rs1,80 lakhs. The resources of the money market as contributed by these non-scheduled banks therefore amount to Rs1,80 lakhs plus Rs50 lakhs or about Rs2¼ crores.

The total resources of banks in Calcutta, whether scheduled or non-scheduled with a paid-up capital and reserve of at least of Rs50,000 amount to Rs120 crores plus Rs2·7 crores, or Rs122·7 crores. The resources of the money market as contributed by these banks in a narrow and a broad sense are as under—

I	II	III
	Cash, balance with bank, money at call and bill discounted and purchased	Column II plus collateral loans
Scheduled Banks ..	About Rs16 crores	About Rs75 crores
Non-Scheduled Banks	About Rs50 lakhs	About Rs2¼ crores
TOTAL ..	About Rs16½ crores	About Rs77¼ crores
	(or in round figures about Rs80 crores.)	

The respective figures for the scheduled and non-scheduled banks bear sufficient testimony to the insignificant rôle the latter play in the money market.

CHAPTER XII

OPERATIONS OF THE ORGANIZED MONEY MARKET

THE operations of the organized section of the Calcutta money market may be grouped under three broad heads. They have reference to the three important component parts of the money market. They are the call money market, the bill market and the collateral loan market.

The Call Money Market

The call money market is confined mostly to dealings between banks. Individuals and institutions, however, sometimes figure in the market as lenders of call money. The scope of this market is by no means extensive in Calcutta, and it is known that it is more active in Bombay than in Calcutta. In Calcutta it is mainly the Exchange Banks which are borrowers of money at call. Indian banks generally do not figure in the market as borrowers of call money, unless they accept call deposits at the year-end for the purpose of 'window-dressing' their balance sheets. The lenders are also generally bankers, whether Exchange or Indian banks, although it is known that on rare occasions banks in Calcutta have borrowed money at call or short notice from private institutions and financiers, e.g., the Hatkhola merchants.

The statutory provision for the maintenance of certain minimum balances by scheduled banks with the Reserve Bank has increased the importance of, and enhanced the demand for, call money as compared to the time prior to the establishment of the Reserve Bank. For any deficiency in the statutory balances that have to be maintained by these

banks with the Reserve Bank entails the payment of a heavy fine. Banks naturally prefer to borrow money at call at a very low rate to tide over such temporary difficulties.

The reason why Exchange Banks are the main borrowers of call money is that they work on a comparatively smaller cash basis. This they are enabled to do in view of their very liquid investments, which include a very large bill portfolio. They may also often be in need of funds for a day or so when their bill offerings are much in excess of their bill maturities, that is when bills offered to them for discount on any day are much in excess of the bills maturing for payment on that day. Such temporary difficulties are also tided over by borrowing money at call or short notice. As the Indian banks generally maintain a fairly large cash reserve, they are normally not in need of call money.

Inter-bank call money is generally arranged through brokers, although banks in need of temporary funds may also approach other banks directly. In Calcutta only a few banks, mostly Exchange Banks, obtain clean call money, that is without any collateral securities. Other banks, if they want to borrow call money, have to provide collateral securities, such as Government securities or Treasury Bills. Such borrowings are in effect collateral loans.

The rate for inter-bank call money varies with the state of the market. It is higher in the busy than in the slack season. It shows a general iendency to decline as from May or June and then rise again as from November or December. This trend is in conformity with the seasonal demand for money. Apart from the influence of the seasonal demand, other particular causes may exert influence upon the call money rate from time to time. For example, heavy Treasury Bill maturities on any particular day may cause a plethora of funds with banks and depress the call money rate. Again,

large demand for funds for financing speculative dealings in stocks or shares or bullion or commodities may make this rate firm up. The actual rate varies between $\frac{1}{4}$ per cent and about 1 per cent according to the period of the year and the demand for call funds in the market.

The Bill Market

There is no bill market in India in the sense in which a discount market exists in London. Yet all the principal banks in India, and particularly the Exchange Banks, discount bills of approved parties provided certain conditions are fulfilled. Genuine trade bills, drawn in connexion with the foreign trade of India, are readily discounted by the Exchange Banks. But there is no market in India for further dealing in these bills. Bills which banks discount for their parties are either carried in their portfolios till maturity, or as in the case particularly of export bills, are rediscounted by the Exchange Banks in the London market. Incidentally it may be mentioned that it is the absence of a proper discount market in India that has stood in the way of drawing Indian export and import bills in terms of rupees.

Although reference has so far been made to trade bills, they are not the only staple of the bill market. Bills, which are dealt with in the money market, may be grouped under two main heads in accordance with their legal form, viz., promissory notes and bills of exchange. The promissory notes are promises to pay issued by the Government of India or Provincial Governments and are known as Treasury Bills. Other bills in the market come under the category of bills of exchange, and may again be divided into bills which are rediscountable with the Reserve Bank and bills which are not. As banks have as yet taken no bills to the Reserve Bank for rediscounting, this distinction has had till now more

theoretical than practical significance. We shall now briefly describe the various types of bills which circulate in the Calcutta market.

Treasury Bills

Treasury Bills, like Ways and Means advances, are short-term Government indebtedness. They carry the security of Government behind them and are usually issued for a currency of three months. As such, they constitute a particularly ideal form of investment for the surplus funds of banks.

In India, Treasury Bills are issued either by the Central Government or by Provincial Governments. By far the largest bulk is issued by the Government of India. India Government Treasury Bills are generally issued for three months. Some of the Provincial Governments have issued Treasury Bills for a longer currency. In 1939-40, the Bengal Government issued six months' Treasury Bills and the C.P. and Berar Government eight months' Treasury Bills.

Treasury Bills are issued by public tender. The Government of India Treasury Bills are issued weekly. Tenders are called for and only the highest tenders are accepted. The bills are issued and paid at the Reserve Bank. In addition to Treasury Bills sold by open tender, intermediate Treasury Bills are sold from time to time either to meet Government requirements of short-term finance or for the purpose of absorbing the temporary surplus funds of banks. This latter process incidentally helps the Reserve Bank to maintain its control over the market.

In India there does not exist, as in London, a market syndicate for applying for Treasury Bills at what are known as Union rates. But as tenders for Treasury Bills in India are confined mostly to a few big banks, they can combine among themselves and create a situation similar to that which obtains in London. One serious defect of the Treasury Bill

market in India is the absence of any material support outside the banks. In London a considerable amount of extra money market funds seeks investment in Treasury Bills. This assists the Government in obtaining better rates. In India the absence of any material outside support makes the Government depend principally upon a few banks for the financing of Treasury Bills, and sometimes the Reserve Bank has to intervene by purchasing bills on its own account to ensure a successful placing of Treasury Bills. Individual and private institutions also tender for Treasury Bills. But the amount tendered for on their own account is very small. They sometimes purchase Treasury Bills through the intermediary of their banks, but such purchases would naturally figure under the amounts tendered for by the banks. Banks are the largest purchasers of Treasury Bills and among them the Imperial Bank occupies a pre-eminent position. Roughly, between 90 and 95 per cent of the Treasury Bills sold to the public by tender or through the tap, is taken up by the commercial banks, of which the share of the Imperial Bank would be about 40 or 45 per cent. The balance of 5 to 10 per cent only is absorbed by private individuals and institutions other than banks.

Reserve Bank and the Treasury Bill Market

It has been already stated that the Reserve Bank has been assiduously trying to widen the scope of the Treasury Bill market. A wider and better organized market in Treasury Bills will have two advantages: On the one hand, it will enable the market to carry a larger floating debt than it does now, and thus reduce the over-all cost of Government borrowing. On the other, it will ensure a better control of the market by the Reserve Bank. For Treasury Bills are rediscountable with the Reserve Bank. In the absence of a well-developed commercial paper market, and in view of the unlikelihood of

its early development, a market in Treasury Bills offers about the only means under present conditions for establishing some form of a co-ordinated organization in, as well as facilitating the control of the Reserve Bank over, the money market.

The intention of the Reserve Bank to develop a wider Treasury Bill market is evidenced by the increasing amounts of Treasury Bill outstandings from year to year, as the following table will reveal:

		Total of the Government of India Treasury Bills outstanding with the public, the Reserve Bank, the Provincial Governments and Burma
At the end of	1935-36	Rs31 crores
,, ,, ,,	1936-37	,, 28·54 crores
,, ,, ,,	1937-38	,, 38·01 ,,
,, ,, ,,	1938-39	,, 46·30 ,,
,, ,, ,,	1939-40	,, 54·71 ,,
,, ,, ,,	1940-41	,, 68·90 ,,

Of these totals, the amount outstanding with the public only varies generally between Rs25 and Rs35 crores.

The following table of the total of Treasury Bills sold also bears testimony to the widening of the market for these bills:

The Government of India Treasury Bill Sales

In thousand rupees

		Amount tendered	Amount sold	Intermediaries sold	Sold in favour of Issue Dept.
Total	1935-36 ..	1,13,31,50	57,76,75	12,73,75	1,00,52,00
,,	1936-37 ..	1,25,99,00	80,98,50	....	62,93,50
,,	1937-38 ..	1,17,86,00	71,99,25	....	75,30,00
,,	1938-39 ..	1,28,90,25	82,13,25	15,35,75	1,00,11,75
,,	1939-40 ..	1,16,96,50	70,50,00	49,93,00	1,04,94,50
,,	1940-41 ..	1,62,48,00	84,00,00	17,32,75	1,40,76,00

In addition to Government of India Treasury Bills, Provincial Governments' Treasury Bills are also sold. But the latter are of comparatively much smaller dimension. In 1939-40, for example, the total of Provincial Governments' Treasury Bills sold was Rs11·80 crores with total outstandings at the end of the year at Rs1·80 crores. The corresponding figures for the Government of India Treasury Bills for the same period are Rs225 crores, of which Treasury Bills and intermediaries sold to the public amounted to Rs120 crores, and Rs54·71 crores respectively.

Calcutta Market and Treasury Bills

It is not possible to estimate the amount of Treasury Bills held in Calcutta, as neither the Reserve Bank nor the balance sheets of most of the banks publish relevant figures. It is known that the Imperial Bank and the Exchange Banks deal largely in these bills, and the bigger Indian banks also carry in their portfolio some portion of Treasury Bills. As the Imperial Bank, which has its principal office in Calcutta, and the Exchange Banks, whose Calcutta offices are generally the most important in India, are heavy purchasers of Treasury Bills, the holdings of these bills in Calcutta must be considerable. Actual figures are unfortunately not available in their balance sheets. The head offices of the big Indian banks operating in Calcutta are outside this province and as investments are mostly, though not wholly, effected at the head offices, the purchases of Treasury Bills by these banks do not directly influence the Calcutta market.

The Bengali banks hardly invest any funds in Treasury Bills. This is unfortunate. For unless they participate actively in the Treasury Bill market by investing their surplus temporary funds in such bills, the efforts of the Reserve Bank to gain control over the market through this means will be

largely infructuous. The reason for the inadequate interest of Bengali banks in Treasury Bills is probably the fact that they attract deposits at comparatively higher rates, and are therefore obliged to invest even their temporary surplus funds in securities which, consistent with maximum safety, will yield the highest return. This condition is satisfied by Government securities. They are safe, and they yield a return of between 3 and 3½ per cent, while the yield on Treasury Bills is below 1 per cent. Further, investment in Government securities can, in case of need, be also utilized for obtaining either short period accommodation from their bigger confrères in the market or demand loans from the Reserve Bank. Thus Bengali banks usually prefer Government securities to Treasury Bills for the investment of even their temporary surplus funds. They also do not appear to be much deterred by the consideration that losses may be sustained if the securities should depreciate in value. For, unless abnormal conditions supervene, securities generally maintain their value, and further under normal conditions fluctuations are not likely to be so great as to neutralize the difference in interest yields between Government securities and Treasury Bills.

A Treasury Bill Market

It has been mentioned that the Reserve Bank has been trying to widen the sphere of the Treasury Bill market in India, and some progress has been achieved. It has to be conceded, however, that this progress is still tardy. The main handicap for developing a wide market in Treasury Bills is the absence of a properly functioning discount market in Treasury Bills. Banks do not yet evince any readiness to discount their portfolio of Treasury Bills. Unless this is done, they will not naturally lock up any large portion of their funds in Treasury Bills. It appears that an operation by

which funds may be obtained by discounting Treasury Bills is looked upon with disfavour in the Indian money market. This attitude of the banks needs readjustment, and it is the duty of the Reserve Bank to institute proper measures for the purpose. The Treasury Bill should be regarded mainly as an instrument of the money market—as almost cash—and not as short period investment, as is done in India. It should function almost as a currency note, against which ready money can be obtained in the market through the intermediary of brokers. Nobody should or need know who is the borrower and who the lender. Discounting of Treasury Bills should be an impersonal operation in the market. If this were done, banks would surely maintain a much larger proportion of their funds than they do now in Treasury Bills, for they would be almost cash to banks. It should be the foremost duty of the Reserve Bank to develop such a Treasury Bill market in India. For, if this were done, not only would the Indian market attain greater resiliency than it now possesses but the control of the Reserve Bank over the money market would also be greatly facilitated.

Other Bills

The most important of these are commercial or trade bills. The obvious distinction between commercial bills rediscountable with the Reserve Bank and bills not so rediscountable has, as already stated, little significance in India. A more practical distinction will be one between foreign trade bills or export and import bills and other trade bills.

Foreign Trade Bills

These bills are either export bills or import bills whose operations may be separately described.

Export Bills

Export bills arise in connexion with our export trade. They are drawn by the Indian exporter, usually for a currency of three months, against credits opened by the buyers with London banks and finance houses and advised to India through the medium of Exchange Banks. The bills are drawn in sterling, although in the case of Japan and China they are in terms of yen and rupees respectively. The usual practice is to draw bills D.A. The rate for a three months' D.A. bill is naturally higher than that for a demand bill to allow for interest during the usance of the bill. This interest is regulated by the rate obtaining at the centre on which the bill is drawn.

When an Indian exporter has drawn a bill, he usually takes it to an Exchange Bank with relative documents and obtains its proceeds immediately by discounting it with the bank. It is rather unusual for the Indian exporter to send his bills to the bank merely for collection, as he will then have to wait for a fairly long period to receive its proceeds. The banks send these bills to London and present them for acceptance, and after endorsement by the Exchange Banks in London the bills are usually discounted in the open market. Unless these banks possess abundant funds in India or trade conditions in India are very slack, it is unusual for them to hold such bills till maturity.

Import Bills

Bills drawn in connexion with the import trade are financed in either of two ways. A small proportion of them is financed by what is known as the London bank's acceptance of 'house' paper. What is meant is that a London exporter, who has got standing with a London bank and is allowed to draw on

it, draws bills, gets them accepted by his bank, and then discounts them in the London market. This is a case of the opening of an acceptance credit by the banker of the seller for the latter's benefit, while the credit furnished in connexion with export bills is an instance of the opening of an acceptance credit by the banker of the buyer in favour of the seller. The accepting bank then forwards the relative documents to its branch abroad for collection of the proceeds of the bills from the London exporting firms' foreign office in India and a remittance is sent to London at or before the maturity of the bill.

The bulk of the Indian import trade is, however, financed by 60 days' bills, usually on D.P. terms, drawn on the Indian importers. In the case of these bills interest has to be paid, usually at 6 per cent, from the date of the bill to the approximate date of arrival of proceeds in London. The London banks which buy or advance money against such bills send them to India for collection. These bills are usually not discounted in the London market, but are held by the banks till maturity, as funds invested in them yield a higher rate of interest than can be secured in London on the proceeds that may be obtained by discounting them in London. As the bills are drawn according to D.P. terms, the Indian importers are not entitled to obtain possession of goods except on payment. This difficulty has, however, been overcome by the device of a Trust Receipt, which the importer has to execute. The significance of the Trust Receipt is that the importer agrees to hold goods or their sale proceeds in trust for the banker until payment has been completed.

The largest bulk of export and import bills is concentrated in the hands of the Exchange Banks. Indian banks engage in this business only to a very small extent. It is not possible to estimate what proportion of the funds of the Exchange

Banks in Calcutta is invested in export and import bills, as no statistics are published.

Other Trade Bills

These bills arise in connexion with inland trade. A distinction may, however, be made between those bills which are in the nature of supplementaries to foreign trade bills, inasmuch as they finance the movement of goods that figure in international trade between ports and inland centres and vice versa, and bills which finance purely internal trade or business. The first category of bills is again financed for the most part by Exchange Banks.

Of the second category of trade bills, their total volume must be very small. The total bills portfolio of scheduled banks in India is roughly only 4 per cent of their total deposits, of which again the bulk must be accounted for by foreign trade bills and bills of the first category.

A brief mention may here be made to the welcome development initiated by Bengali banks of extending dealings in a form of trade bills, which cannot be properly described as genuine bills of exchange, as more often than not they are not accepted by the parties on whom they are drawn. A very common form of these bills are those drawn against the supply of goods to Government departments, railways, public and semi-public institutions and large commercial houses. There is, of course, no open market in these bills, nor is one likely to develop unless certain conditions are fulfilled. An essential preliminary is that they should be accepted by the parties on whom they are drawn. If Government departments, public and semi-public institutions and big commercial houses would only evince greater interest and co-operation, and agree that supply bills should be drawn for a definite currency and further accept them, an extensive

commercial paper market as in the U.S.A. might be developed in Calcutta, as also in other financial centres in India.

Hundis of Shroffs

Another form of bill of exchange which big commercial banks in Calcutta discount are hundis drawn by parties, who are financed by indigenous bankers and accepted by the latter. Approved shroffs have limits fixed for them by big commercial banks in Calcutta. The Imperial Bank, some of the Exchange Banks and big Indian banks in Calcutta undertake this business. Although it is difficult to estimate the amount of such hundis discounted in Calcutta, it is likely that it would be anything between Rs40 and Rs50 lakhs in Calcutta in normal times. It will, however, be much smaller at the present moment.

Collateral Loan Market

Of the individual markets the collateral loan market is by far the most important in Calcutta or in any other financial centre in India. It is probably also the most important constituent of the money markets in foreign countries, with the exception of Great Britain. The percentage of advances of scheduled banks in India to their total deposits is something between 45 and 50. In the Calcutta money market also, this proportion for the scheduled banks is about 50 per cent.

Form of Collateral Loans

Collateral loans in Calcutta, as also elsewhere in India, generally assume either of three different forms, viz., loan, cash credit or overdraft account. The last two are operated through the current account of the customers. Loan account is, however, treated as a separate account. A loan can be obtained by a person who has no current account with a

bank. In order, however, to operate a cash credit or overdraft account, a person must have a current account with the bank.

Nature of Collateral

A collateral may be any kind of security which will be acceptable to the banker. Usually securities, which are easily marketable and do not fluctuate much in price, are accepted by banks. Such securities are marketable commodities, stocks and shares, and bullion. Houses, properties or fixed capital of industries are usually not accepted as collateral for making advances. Even in respect of stocks and shares, and commodities, whether agricultural or manufactured, only such of these are normally accepted as can be easily sold and command a steady price. Delivery orders in respect of raw jute or gunnies are also a common form of collateral in the Calcutta market. In rare cases other forms of collaterals such as land, buildings, fixed capital, life insurance policies, fixed deposit receipts, etc. are accepted by banks.

Purposes of Collateral Loans

Collateral loans may be obtained for speculative or consumption purposes. In all countries a considerable portion of collateral loans find their way to the stock market. Borrowers are usually stock-brokers, but may as often be private individuals. When a private individual borrows for holding securities, the purpose may be as much genuine investment as speculation. If he intends to hold the securities as a long period investment he is a genuine investor. If he holds them merely to sell them off at the earliest opportunity at a profit, he is a speculator.

Collateral loans are also obtained for commercial and business purposes, and in particular to finance the short-term needs of businessmen.

Individuals in difficulty also arrange for collateral loans for consumption purposes. But the proportion of these to the total of collateral loans must be very small.

Overdraft Account

Overdrafts, that is the right to overdraw their accounts by bank's customers, are usually granted against the security of stocks and shares, jute and gunny delivery orders and bullion. Sometimes advances are granted against the borrower's own promissory note with or without a guarantor but without any collateral. Such advances, however, constitute a very small proportion of the total advances granted by scheduled banks.

Banks allow their customers to overdraw their accounts against securities only up to an agreed margin. The margin that banks demand varies from security to security. For example, in normal times, banks advance 90 per cent of the market value against Government securities, 60–70 per cent of the market value against first class jute and coal shares and so on. The rate of interest charged varies with the standing of the parties and the state of the bank's funds. Against Government securities or first class shares, or jute or hessian delivery orders, respectable borrowers should be able to obtain advances at a little over and sometimes even at the bank rate. If conditions in the market should be very easy, the rate may even be lower than the bank rate.

By far the largest proportion of advances is granted against stocks and shares either to stock-brokers or private parties. All banks in Calcutta advance such loans but it is known that the Allahabad Bank, the Bank of India and the Bank of Baroda, are the most important institutions in respect of advances made to stock-brokers against the security of stocks and shares.

Cash Credit Account

Cash credit arrangements are usually made against the security of commodities, agricultural or manufactured, stored either in recognized warehouses or mostly, in view of the dearth of good warehouses, in banks' own godowns. The market value of the commodities are first ascertained and advances are made varying up to between 50 to 70 per cent of their value. As in the case of overdrafts, the margin demanded varies with the credit of the customer as well as the nature of the commodity offered as collateral. Advances are also granted in the Calcutta market against the security of a commodity which is not stored in a recognized warehouse or bank's godown, but is still in the process of growth. The most common form of this advance is that granted against the hypothecation of tea crops.

A cash credit account operates just like an overdraft account. The customer is allowed a limit up to which he can overdraw. He releases goods in part or in whole, against proportionate or full payment. As goods are released against payment, permissible limit of overdrawing is also correspondingly reduced.

The rate of interest charged on a cash credit account is usually higher than that charged on an overdraft account allowed against the security of stocks and shares, jute or hessian delivery order, etc. This is as it should be. For goods cannot be so easily and speedily sold off as stocks and shares. The rate of interest on cash credit is usually between 1 and 2 per cent over bank rate.

One advantage of a cash credit or overdraft account is that interest has to be paid only on the amount overdrawn at any time and not on the full amount up to which the customer may be allowed to overdraw his account. To

safeguard the bank against loss that may ensue by its customer not overdrawing his account at all, although it has to keep funds free for this eventuality in terms of the agreement made with him, an interest clause is sometimes included in the cash credit or overdraft agreement by which the customer is obliged to pay interest to the bank on certain proportion of the amount arranged for, say one-third or one-fourth, even though he may not have overdrawn his account to this extent.

Loan Account

A loan may be arranged against any form of collateral acceptable to the bank. In general loan accounts are opened for consumption purposes, or for long period requirements of industries against the security of block capital. They are usually of longer duration than overdraft or cash credit advances, and would in many cases not fall within the ambit of the operations of the money market proper, as concerned with short period financing.

The rate of interest charged on loan accounts is usually higher than that charged on other forms of advances. Interest has to be paid on the full amount until the loan is repaid. This is the main reason why loans are not favoured by businessmen.

It is, however, not possible to estimate separately the amount of advances under the heads of overdraft, cash credit and loan, as relevant figures are not available. Most of the banks lump together all these items under one head in their balance sheets. Of the larger banks only the Imperial Bank, the Allahabad Bank, and the Bank of India publish the figures for loans separately, while overdrafts and cash credits are lumped together. Of the total investments of these banks in loans, cash credits and overdrafts, the percentage of loans

is 25, 9 and 40 respectively for the Imperial Bank, the Allahabad Bank and the Bank of India.

Principal Borrowers and Methods of Financing

Apart from persons who operate on the Stock Exchange, the principal borrowers in the Calcutta money market are the main industries and trades which obtain finance from it. A brief description of the way in which these industries and trades are financed by the Calcutta money market will facilitate an understanding of the function as well as the importance of this market.

Jute Industry and Trade

The jute trade and industry occupies the foremost place in the economic life of Bengal. The jute industry does not require much financial assistance from banks. Most of the old mills are in a position today to meet the requirements of their working capital from their own funds. The newer mills may require accommodation from banks and obtain it under the cash credit system against the security of their floating stock. In addition the managing agents themselves usually guarantee the advances granted by banks.

In the jute trade, there is a two-fold division, viz., raw jute and jute manufacture. In the raw jute section, the main problem is how to finance the transport of raw jute from the moffussil areas to Calcutta. There are a European and an Indian side in this business. The European side consists of the mills with their own out agencies in the moffussil for the purchase of raw jute, brokers with their out agencies in the moffussil, and Ralli Bros. with its own organization in the moffussil. The Indian side consists of many Marwaris with their purchasing agencies in the moffussil centres, and a class of traders called 'Aratdars, or, Beparis' with their own buying

agents in the villages. On the European side the mills and Ralli Bros. usually depend on their own funds. The brokers resort more to banks for finance. When accommodation is required by any of them, it is obtained from banks under the cash credit system against the security of floating stock. It is presumed that hardly 10 per cent of the funds required for the movement of jute from the interior to Calcutta and for storing it in the metropolis is provided by banks. On the Indian side, the Marwaris and the aratdars generally provide their own finance. When accommodation is required, very often they obtain it from the indigenous bankers against the security of muddati hundis. Another method of financing the movement of jute from the interior to Calcutta is by means of accommodation obtained from banks against delivery orders of jute presses, which receive raw jute for baling. Many Indian mills take advantage of this form of overdraft accommodation.

In so far as the financing of jute manufactures is concerned, it is generally undertaken by a class of intermediaries called hessian dealers. They take away from the manufacturer all responsibility of finance from the moment the jute has been manufactured. They in their turn, when necessary, readily obtain accommodation from banks under the overdraft system against hessian or gunny bag delivery orders.

Coal Industry and Trade

The coal industry is mostly controlled by European managing agency firms. Almost 90 per cent of the interest in the coal industry is in European hands. The properties belong to Indians but leases have been given to European firms. The European managed coal mines are generally in good financial condition, and hardly require assistance

from banks. Of the Indian collieries, the good ones find little difficulty in obtaining accommodation from banks under the cash credit system against the security of stocks of coal and generally backed by the guarantee of the managing agents. Collieries which are not so well placed have to depend on private financiers, and sometimes indigenous bankers, for necessary finance. Accommodation is granted against promissory notes or hundis and sometimes backed by collaterals.

The coal trade is for the most part privately financed. But a number of bills in connexion with coal supplied to distant places, such as Ahmedabad or Sholapur, passes through banks. They are usually D.P. bills accompanied by railway receipts; and banks either discount them or grant overdrafts against their security.

Cotton Industry and Cloth Trade

The cotton mills in Bengal, unlike those in Bombay, have to be financed largely by banks. If finance is required for working capital, it is generally provided under the cash credit system against the security of stocks. Some banks have also granted long-term loan against the security of block capital. Usually the guarantee of the managing agents, if any, is also obtained as an additional security.

The cloth trade is practically entirely in the hands of Marwaris as middlemen. They usually provide their own capital; but for any additional financial requirement, they may obtain accommodation against hundis from indigenous bankers, who, in their turn, may again discount these hundis with commercial banks. Banks, however, finance to a considerable extent the piecegoods trade by providing accommodation under the cash credit system.

Tea Industry

Ever since the introduction of the tea restriction scheme, the tea industry has had little difficulty in obtaining accommodation from banks. Financial assistance is provided by banks against the hypothecation of tea crop. The guarantee of the firm of managing agents is also demanded in many cases as an additional security. A loan hypothecation account is opened in the party's name from which, in accordance with the arrangements entered into, amounts are credited monthly to the party's current account. As tea is manufactured and sold, the sale proceeds are credited to loan hypothecation account and the advance allowed is gradually paid up.

Iron and Steel Industry

Today the iron and steel industry require little financial assistance from banks. The Tata Iron and Steel Co. has an overdraft arrangement with the Imperial Bank against the security of its floating stock. Other companies have similar arrangements with banks. It is interesting to observe that one method resorted to by the Tatas, on a considerable scale in the past, to obtain temporary financial assistance, was the creation of debentures which, instead of being issued to the public, were handed over to the bank concerned. This enabled the company to obtain accommodation at a cheaper rate.

Miscellaneous Industries

There are many other industries in Calcutta which obtain temporary financial assistance from banks under the cash credit system against the security of stocks. It should, however, be added that smaller industries find it extremely difficult to secure financial assistance from banks for even their

short period requirements. They have generally to raise funds from private sources and as such have to pay higher charges. Sometimes the smaller banks may grant them accommodation under the cash credit system against the storage of finished goods or raw materials in the banks' godowns.

Export and Import Trades

The financing of these trades have already been explained. It need only be added in connexion with the import trade that, when parties, particularly manufacturers or large dealers, import goods on their own account, and find themselves short of funds at the time of releasing the relevant documents, accommodation may be obtained from banks against the security of goods imported and stored in the banks' godowns.

Stock-Brokers

Stock-brokers constitute an important class of borrowers in the Calcutta money market. They are given overdraft accommodation by banks against the security of stocks and shares under blank transfer deeds. Advances are allowed only up to a certain percentage of the value of securities deposited with the bank.

Structure of Interest Rates

There are two groups of interest rates which banks are concerned with, viz., the borrowing rate and the lending rate.

Borrowing Rates

There is no uniformity of the rate of interest which banks in Calcutta pay on the deposits they receive from the public. There are three main kinds of deposits accepted by banks, viz., Current, Savings and Fixed. The present rates of interest paid by different banks in the Calcutta market are as

follows. The Imperial Bank pays no interest on current account. It pays, however, an interest of 1½ per cent on savings deposits. Fixed deposit rates have to be ascertained on application. The Exchange Banks pay ½ per cent on current deposit account and 1½ per cent on savings bank account. Their rates of interest on deposits for varying fixed periods are governed by what are known as 'Union rates', i.e. rates which have been agreed to between them. Big Indian banks, non-Bengali or Bengali, generally follow the rates of the Exchange Banks in respect of current and savings bank accounts. The smaller banks pay comparatively higher interest rates on these accounts but even then there is no uniformity of rates among them. There is also no uniformity among Indian banks in respect of the rates of interest paid on deposits for varying fixed periods, e.g. for 6, 12, or 24 months. A peculiar feature of the Bengali banks, particularly in respect of interest paid on fixed deposits, is that they vary for the same bank in Calcutta and moffussil areas. Generally the rates paid in moffussil areas, which include in many instances the head offices of the banks, are higher than those paid in Calcutta.

Lending Rates

These may be grouped under three broad heads, viz., call money, bills and collateral advances.

The call money rate varies with the season of the year being higher in the busy and lower in the slack season. It varies usually between ¼ and 1 per cent.

In the bill market there is a division between foreign bill rates and inland bill rates. The rates for foreign bills are quoted everyday in the Calcutta market by banks which deal in foreign exchanges. The current rates are as follows:

T.T. 1*s*. 5.15/16*d*.; Demand bills 1*s*. 5.15/16*d*.; 3 months' bills 1*s*. 6.7/32*d*.

Inland bill rates are generally ½ to 1 per cent over bank rate, and the present rates are as follows:

Non-documentary D.D. and documentary D.P. bills—3½ to 4 per cent, i.e. ½ to 1 per cent over bank rate.

Documentary D/A bills—4 per cent, i.e., 1 per cent over bank rate.

There are various forms of collateral advances. The rate charged on such advances generally vary between bank rate and 2 per cent over bank rate. As the bank rate today is 3 per cent the maximum rate charged on collateral advances is hardly ever over 5 per cent. Some idea of the rates obtaining now in the Calcutta money market on various types of advances may be gleaned from the following figures in respect of the principal kinds of bank advances:—

Advances against—

(*a*) Government Securities: 3 to 4 per cent, i.e. bank rate to 1 per cent over bank rate.

(*b*) Marketable Stocks and Shares: 4 to 4½ per cent, i.e. 1 to 1½ per cent over bank rate.

(*c*) Bullion: 3½ to 4 per cent, i.e. ½ to 1 per cent over bank rate.

(*d*) Hessian or gunny bag delivery orders: 3½ to 4 per cent, i.e. ½ to 1 per cent over bank rate.

(*e*) Goods under cash credit system: 4 to 5 per cent, i.e. 1 to 2 per cent over bank rate.

The rate of interest charged varies not only with the type of security offered but also with the standing of the borrower. Good parties obtain accommodation at cheaper rates than parties not so well known. Further, rates also sometimes vary with the amount of advance taken. They are generally more favourable for larger than for smaller amounts.

There is another kind of advance of some importance which may be briefly mentioned. This is a clean advance to shroffs or merchants against joint or several promissory notes. The rate of interest charged now varies between 3½ and 4 per cent, i.e. ½ to 1 per cent over bank rate.

CHAPTER XIII

THE RESOURCES AND OPERATIONS OF THE BAZAAR MONEY MARKET

IN this chapter, we shall confine our observations only to indigenous bankers. Although moneylenders as a class may be regarded as a constituent of the bazaar money market, it is impossible to estimate their resources, while their activities have little direct bearing on the money market.

To assess the resources and describe the operations of the indigenous bankers is not easy. For, generally speaking, their activities are shrouded in a veil of secrecy. Personal discussion and enquiries have, however, yielded valuable information in respect of their working in Calcutta, and this is detailed below.

Resources of the Indigenous Banker

The resources of the indigenous bankers in Calcutta normally amounted to approximately Rs2 crores contributed by the different sections as follows:

Marwaris	..	about Rs 1 crore		25 lakhs.
Multanis	..	,,	,,	50 lakhs.
Bengalis and Gujratis		,,	,,	25 lakhs.

Since the outbreak of the present war the business of the indigenous bankers has materially declined. In certain cases, the enactment of the Bengal Moneylenders' Act has also had a depressing effect on this business. Another contributory factor has been the dissolution or the impending dissolution of certain big Marwari firms owing to disputes among their partners. The businesses of such reputed Marwari firms as Harsukhdas Balkishendas, Tarachand Ghanasyamdas, Bansilal Abhirchand, etc., have been seriously affected

by this fact. The present resources of the indigenous bankers in Calcutta will, therefore, be roughly between Rs60 and Rs70 lakhs, contributed by the various sections as follows:

Multanis	..	Rs30–40 lakhs.
Marwaris	..	Rs20–25 lakhs.
Others	..	about Rs5 lakhs.

A noteworthy fact about the resources of the indigenous bankers is that they are also influenced by the extent of good borrowers available in the market. If money is greatly in demand by substantial and trustworthy parties, indigenous bankers augment their funds by various means such as transfer of funds from other offices, discounting of their hundis with commercial banks, acceptance of deposits in certain cases or borrowing in the market. The most common method for augmenting funds is by discounting their hundis, mainly with the commercial banks. This bears testimony to the comparatively greater elasticity of the bazaar than the organized money market, owing to the existence of some kind of a bill market.

Operations of the Indigenous Banker

The operations of the indigenous bankers may be studied under three broad heads: viz., (*a*) how funds are obtained, (*b*) how funds are invested, and (*c*) other banking activities.

(*a*) *How funds are obtained*

A large proportion of the resources of the indigenous bankers is contributed by themselves. It has been already stated that the Multani and Bengali bankers do not accept deposits. Some of the Marwaris do, and in such cases, the proportion of borrowed to owned funds is usually in the ratio of 2: 1. Deposits are accepted under what is known as the

'Khatapeta' system. In its practical operation it is like a current deposit account, although no vouchers or receipts are in use. Entries in the banker's ledger are considered sufficient both for deposits made and interest received or withdrawals effected and interest paid. Only when moneys are deposited or withdrawn through a bearer is a purja slip used. A purja is in the nature of a receipt given by the borrower to the lender. Thus, when moneys are deposited through a bearer, a purja is given by the banker to the party's bearer acknowledging receipt of the money. Again, when the depositor withdraws money from his account with the banker through a bearer, a purja is sent by the depositor through the latter to the banker acknowledging receipt of money from the banker. When moneys are paid in or withdrawn directly by the depositor, no receipts are used.

When the indigenous banker's own resources, supplemented in certain cases by deposits, fall short of his needs, he may raise funds by either discounting his hundis or borrowing from other bankers. In respect of discounting of hundis, it is interesting to note that such discounting is effected not solely by commercial banks. Although the latter are the principal agency for discounting hundis, private traders and indigenous bankers themselves often discount hundis. If private merchants have at any time surplus funds in their possession, they may invest such money in the hundis of indigenous bankers. They discount such hundis at a rate of about 2 to 3 annas per month per cent or between Rs1-8 and Rs2-4 per cent per annum. The Nakhoda merchants are known to invest their surplus funds in this way. Indigenous bankers themselves may sometimes invest their surplus funds in purchasing the hundis of other bankers. By far the largest amount of discounting is effected with commercial banks. The hundis dealt with are mostly muddati or usance hundis.

But sometimes the indigenous bankers may also augment their funds by drawing a demand draft on any of their other offices, and discounting same with commercial banks.

In connexion with borrowing by one banker from other bankers, it will be recalled that the Multanis do not go outside their own section, nor do they borrow for more than one day. This is known as 'dasti'. There is no convention among Marwaris or Bengalis to borrow from members of their own sections only. When funds are borrowed by them, they may be borrowed for a fixed period or on condition that they will be repaid on demand, mostly in accordance with the wishes of the lending banker. There is, however, a convention among the Bikanir Marwaris that their members borrow from each other for a period of three days only.

(*b*) *How funds are invested*

The funds of the indigenous bankers are employed in lending to borrowers, about whose credit and standing in the market they are satisfied, against muddati or deferred or usance hundis. It may be observed in this connexion that prior to the entry of the Multani bankers into the Calcutta market, lending of money against usance hundis was not common. The most prevalent instrument for the lending of money was the promissory note. Before 1936 or 1937 only a comparatively small amount used to be lent against usance hundis. It was from about this time that Multani bankers began to operate on an appreciable scale, in the Calcutta market and play an important part in popularizing the use of hundis. The usance hundis are usually drawn for a period of ninety days but may also be for a shorter duration. At the present moment, shorter dated hundis have grown in number owing to the uncertainty created by the war. Usance hundis are generally in use for borrowing money. Darshani hundis

or sight or demand drafts figure mostly in remitting funds or sending bills for collection.

Usance hundis, which are the most popular form of instrument for lending money, are generally unaccompanied by any document of title to goods. As such, it is not possible to say whether these hundis are merely in the nature of accommodation bills or have been drawn in connexion with genuine trade transactions. As moneys are lent primarily against the personal credit and standing of the borrowers, these hundis mostly resemble accommodation bills.

It has been already stated that the indigenous bankers make no distinction between different classes of borrowers. They lend to anybody about whose credit and standing in the market they are satisfied. A distinction has, however, to be drawn between a borrower who wants funds for speculative purposes and one who wants funds for genuine trade purposes. The Multani bankers deal only with genuine trading classes. They do not lend to persons who speculate, e.g., in jute or stocks and shares. If they lend to people who deal in jute, it would be to those who purchase jute in moffussil areas for the purpose of selling it in Calcutta. The Marwaris, however, lend money also to people who undertake speculative business, and sometimes they themselves engage in such business.

The rate of interest charged by the indigenous bankers varies to some extent. With Multanis, the lowest rate will be something between 3 and 5 per cent, and the highest about 15 per cent, with 7 or 8 per cent as the usual rate. The Nakhoda merchants are recognized to be the best borrowers in Calcutta, and obtain funds at the cheapest rate. With Marwaris, the rate varies from 3 to 15 per cent, with 9 per cent as the average rate. With Bengalis, the rate usually varies between 9 and 15 per cent. It should, however, be added that in

a few cases very high interest rates have been paid by borrowers in the Calcutta market. These rates have ranged from 24 to 48 per cent, and sometimes even more. But such rates were charged only in the case of a few parties, and some portion of the funds so lent has become almost unrealizable and has to be treated as a bad debt. The shroffs affected are mostly Marwaris and Bengalis.

Collection of Darshani hundis

The only other important activity of the indigenous banker arises in connexion with the collection of darshani hundis or demand drafts. These hundis may arise in two principal ways. In the first place, they may have been drawn by merchants for goods supplied to merchants in other centres, and may or may not be supported by relative documents such as railway or steamer receipts. These hundis are therefore in the nature of demand bills and are collected through the intermediary of the indigenous bankers. In the second place, these hundis may be drawn in connexion with the remittance of funds from one centre to another. This remittance may be undertaken on behalf of parties or the shroffs themselves. Sometimes a well-known merchant or businessman operating in various centres may draw at one centre a hundi on its office at another centre, and discount it immediately with an indigenous banker who sends it to the centre at which it has been drawn to be paid, for collection. Hundis drawn for purposes of remittance of funds are in the nature of demand drafts.

Procedure of Collection

The procedure of collection of darshani hundis is two-fold according as they are or are not left with the parties on whom they have been drawn. Let us first illustrate the case of the hundi which is left with the banker on whom it is drawn.

On receipt of a darshani hundi by a shroff for collection, he may present it on the drawee banker for acceptance on any working day up to 6 P.M. The hundi is sent for acceptance along with a perforated receipt in the following form:—

Name of Collecting Shroff.... .....

Accepted on ....

a hundi for Rs................ .

Date ....

.. ..
Signature

....
Name of the Collecting Shroff

Date............

Hundi No......................

Name of drawee............................

Name of drawer..........................

Endorsed by...............................

Date of hundi.............................

Amount Rs.............................

Signature...................

When the hundi is presented for collection, the collecting banker leaves the hundi together with the lower portion of the perforated slip, which is filled up by him, with the drawee bank; and the drawee banker signs the upper portion of the slip and returns it to the collecting banker through the darwan who presented the hundi for collection. On the following day by 2 P.M., the drawee banker has to intimate to the collecting banker his acceptance of the hundi, and

returns it to the latter by obtaining in return the receipt he had signed the previous day. Thereupon, the collecting banker will write his discharge on the hundi and send it through his darwan to the drawee banker for collection before 6 P.M. The drawee banker will make payment and obtain a receipt from the collecting darwan to the effect that payment has been received.

In the case of those bankers, who do not leave the hundis with the drawee bankers, the procedure of collection is the same as described above with this difference, that hundis are not left behind by the collecting bankers. Instead they are merely shown to the drawee banker or a copy of the hundi may be supplied to the latter.

This description of the procedure of collection reveals that a day's grace is normally allowed for the payment of darshani hundis. For hundis presented for payment on any day become due for payment on the following day. It may be noted here that no grace period is allowed for the payment of muddati hundis.

If darshani hundis are not paid in due time, i.e. on the day following the date on which they have been presented for acceptance the following penalties have to be paid:

(*a*) Up to three days after the due date, an interest calculated at 6 per cent.

(*b*) Up to two more days, interest calculated at 9 per cent.

If a hundi remains unpaid even after the sixth day, counted from the date on which it was presented for collection, the fact of non-payment has to be notified to a Committee called the Darshani Hundi Committee, which, after making enquiries, certifies that the hundi has not been paid. Action thereafter has to be taken against the drawer of the hundi, who has to pay various penalties.

Darshani Hundi Committees

In Calcutta there are two Darshani Hundi Committees. One Hundi Committee has for its members those indigenous bankers who leave their hundis for collection with the drawee bankers. This is known as the Darshani Hundi Committee of Banstala Lane. The other Darshani Hundi Committee is concerned with those bankers who do not leave their hundis with the drawee bankers. This is called the Darshani Hundi Committee of Harrison Road.

The function of both the Committees is the same. They certify the fact of non-payment of a hundi when it remains unpaid even after the sixth day. Their services in this matter are therefore in the nature of those of a Notary Public.

Remittance of Funds

The instrument through which funds are remitted is usually the darshani hundi. But there is a peculiarity in connexion with remittance of funds by indigenous bankers which deserves mention. If funds are remitted through banks, a charge has to be paid by the person who wants to remit funds from one place to another. But this is not always the case with the indigenous banker. With him the question as to which party, the banker or the person desiring remittance, will, if at all, pay the remittance charge will depend upon the relative urgency of the need for funds by the respective parties at the places concerned. In the busy season, for example, it is more often than not that a shroff in Calcutta who is undertaking the remittance operation will pay commission to the party in whose behalf funds will be transferred. Thus, if there be one party *A*, who may also be a shroff, who has funds in Calcutta and wants to transfer them to Bombay,

and another shroff *B*, who agrees to do so, then in all probability *B* will pay commission to *A*. In the slack season, remittance of funds may be undertaken at par or a commission may be charged. The guiding factor as to which party will pay commission, if at all, is the relative urgency of the need for funds on the part of the banker at Calcutta and of the party, who may also be a banker, at some other centre where he desires funds to be transferred. The rate of commission, when and by whichever party paid, varies from one-fourth to one-half per cent.

Instruments of the Bazaar Market

The principal instrument of the bazaar money market is the hundi. There are, as already mentioned, two different forms of hundis, viz., darshani and muddati.

Darshani Hundi.—A darshani hundi is usually in the nature of a demand draft drawn by one office of an indigenous banker on another or its agent. The usual form of a darshani hundi is as follows:

Seth A.B.C. (name of banker)

(Place on which drawn) (Date)

On demand pay to..........................or bearer the sum of Rs.....................for value received from..................

Rs........ ....
(Signature of issuing banker)

In some of these drafts, the words, 'for value received from ....', are not mentioned.

The darshani hundi may be drawn in four different forms according to the way in which the payee is described. These forms are known as dhanijog, sahjog, firmanjog and dehkanhar [1]. The most common form in use is the dhanijog. A dhanijog hundi means that it has to be paid to the payee only. Further it cannot be transferred by means of endorsement. In the hundi, only the name of the payee will be mentioned and the words 'or bearer' will be struck off. Such a hundi, it will be seen, bears some resemblance to an 'account payee' cheque. A sahjog hundi is one which is payable to any respectable shah or merchant. The hundi is not made payable to any particular person. Instead of the name of the payee, appear words to this effect: Pay to 'at Bombay (or any other place) any shah bepari according to the custom and usage of the place'. A sahjog hundi can be endorsed and transferred. A firmanjog hundi is one made payable to a particular person or order. It can therefore be endorsed and transferred. A dehkanhar hundi is one which is payable to bearer.

There is another instrument in common use in the market which is known as a promissory note, but may also be regarded in the nature of a darshani hundi. Its form is as follows:

On demand, $\frac{\text{I}}{\text{we}}$ promise to pay to..............................

the sum of Rs............for value received in cash with interest at the rate of.....................

....

Signature

Date................

Muddati Hundi.—A muddati or usance hundi is one which is payable after a fixed period of time, and no grace days

[1] Jain: *Indigenous Banking in India*, p. 73.

are allowed. The usual form of a muddati hundi is as follows:

Rs.......... Due..........194

Calcutta

....194

At ( )..................days after date without grace days please pay to.............................or order the sum of Rs........ .for value received in cash.

Payable at........................

To.............................. ....

(Name of drawer)

....

(Name of drawee)

The muddati hundi may also be drawn in various forms according to the way in which the payee is described. But the most prevalent form is the firmanjog, which is that of a bill of exchange. The hundi is payable to the payee or order, and is transferable by endorsement. A muddati hundi can also be drawn in the dhanijog form, in which case it will have to be paid only to the person mentioned in the hundi. Although Dr Jain mentions 'sahjog' as another form of muddati hundi, it is hardly ever likely that a muddati hundi will be drawn in this form. It certainly does not appear to be in use. Another special form is the jokhami hundi. It is drawn against goods despatched, and usually contains the condition that 'if the goods on the security of which the advance is made are lost or damaged in transit, the drawer or the holder of the hundi has to suffer the loss.

Analogous to the demand promissory hundi, there is a muddati promissory hundi. Its form is as follows:

Rs.... ... Due....... ..194

Calcutta

..............194

At ( )..............days after date without grace days $\frac{\text{I}}{\text{we}}$ promise to pay to..................................or order the sum of Rs............for value received in cash.

....

Signature

Stamp Duty on Hundis

There is no stamp duty on hundis which are in the nature of demand drafts. The stamp duty on demand promissory notes is one anna up to Rs199, two annas on amounts from Rs200 to Rs499, and four annas on sums of Rs500 or over. The stamp duty on muddati hundis is two annas for every thousand rupees.

CHAPTER XIV

GOVERNMENT AND THE MONEY MARKET

EVERY Government receives through taxation colossal sums which it again pays out through its Exchequer in various forms. These operations naturally affect conditions in the money market. Further, the borrowing requirements and policy of a Government has also intimate repercussions on the money market.

In early times Government balances were maintained in independent treasuries, with the result that large tax receipts at one time and heavy disbursements at another exerted very disturbing influences on the money market. With the growth of reliable banks, and particularly of Central Banks, Government balances have been entrusted to the care of the latter. In the modern world it is through the medium of the Central Bank that the repercussions of the Government's financial operations are felt in the money market. 'In the complicated world of modern finance,' observes Sir Basil Blackett [1], 'the relations between the Treasury and the Central Bank of a country and between them and the money market are of vital importance. Expert management of Government's banking accounts is essential, if the delicate machinery of finance is to work smoothly, and the control of credit cannot be handled without wasteful friction, if the Treasury and the banking system are not in close and constant touch.'

Central Bank and the Government

There is a general consensus of opinion that the Central Bank [2] should not only act as the Government's bankers

[1] Foreword to Dodwell's book on *Treasuries and Central Banks*, p. ix.

[2] For a discussion of the comparative merits of the Government

but also fulfil the function of its agent and adviser. The Macmillan Committee observed[1] in respect of the relationship between the Government and the Central Banks as follows:

'In practice the tasks which have been imposed upon the Central Bank make it imperative that it should hold the account of the Government, for the financial operations of the Government are conducted on a scale so great as seriously to derange the money market, unless special measures are taken to counteract the inconveniences which result from the inflow of revenue or the temporary easiness which results from interest and dividend payments. This task ought to devolve upon the Central Bank in virtue of its general function as guardian of the money market, and does in fact devolve upon it when it carries the Government account.'

Influence on the Money Market

In every country the influence of the Government's financial operations on the money market as exercised through the Central Bank, may be studied in a two-fold aspect, corresponding to the two main services rendered by a Central Bank to the Government as the latter's bankers, and as responsible for the management of the public debt.

Central Bank as the Government's Bankers

In this capacity the Central Bank maintains the banking accounts of the Government departments and enterprises, receives payments on their behalf and provides cash and other banking facilities required by them for purposes of

operating through an independent treasury system, Central Bank or commercial banks, see Dodwell: *Treasuries and Central Banks,* Ch. 1.

[1] *Report of the Committee on Finance and Industry,* p. 16.

disbursement. If the Government should temporarily be short of funds, the Central Bank provides it with short-term accommodation in anticipation of tax receipt or the raising of loans from the public. It is also entrusted with the duty of furnishing the Government with its requirements of foreign exchange.

The receipt of taxes, particularly as receipts are generally not spread uniformly throughout the year, and disbursements made by the Government, particularly at periods when it has to pay interest on its debts, would have serious effects on the money market unless suitable measures were adopted by the Central Bank to offset them. For payment of taxes transfers large funds from the public to the Government Exchequer and has the effect of making conditions in the market stringent. Contrariwise, large Government disbursements, as when interest payments are effected, transfer funds from the Exchequer to the public and are responsible for easier conditions in the money market. If receipts and disbursements balanced each other, the effect on the money market would be nil. But often they do not; and large withdrawals of funds from or payments to the public have disturbing consequences on the money market. As Sir Ernest Harvey stated in course of his evidence [1] before the Macmillan Committee, the Central Banks endeavour 'to ensure that the ebb and flow of these movements in Treasury Finance shall not cause any unnecessary or avoidable disturbance in market conditions'. This it does by undertaking suitable open market operations. Thus Kisch and Elkin write, [2] 'It is well known that by its open market operations the Bank is able to maintain relatively stable conditions when carrying out large money operations connected with Govern-

[1] Qn. 454. [2] *Central Banks*, p. 104.

ment and international finance, and to mitigate the disturbances that would otherwise be caused by large transfers of funds between the State and the tax-payer and by other factors of a similar type '.

The Central Bank and Management of Public Debt

In every country Government policy in respect of its public debt, and as carried out in practice by the Central Bank, exercises considerable influence on general financial conditions. This influence is particularly manifest when the Government is under the necessity of borrowing from the market to meet its financial obligations. The main impact on the money market in connexion with the Government handling of the public debts arises in two ways. In the first place, there is the consideration of making the market favourable to the reception of a public loan, whenever Government needs to float one. In the second place, there is the further consideration of keeping the cost of the public debt as low as possible. These considerations may bring, and have often actually brought, the interests of the Government and the money market in open conflict. 'It might almost be said,' observes Mr Grant, 'that the Treasury has a vested interest in low money rates, and consequently there exists a possibility, of course not an inevitability, that an objective monetary policy may be difficult on that account '[1]. Thus this desire to maintain low interest rates may come in conflict with any need to restrain credit, either in the interest of stabilizing the exchanges or controlling general economic activity. It may also be decided to maintain a large proportion of the debt in short-term borrowing so as to keep the average cost at a low level. Further, whenever the Government should desire

[1] A. T. K. Grant: *A Study of the Capital Market in Post-War Britain*, p. 71.

to float a loan, special measures may be adopted to influence credit conditions. Thus in England, 'the activities of the Bank of England and the National Debt Commissioners will be directed to strengthening the position of the Treasury and weakening that of the lenders, and rival borrowers will be kept out of the market as far as possible '[1].

The long-term borrowing operations of the Government have influence primarily upon the capital market and short-term borrowings, on the money market. In respect of short-term borrowing again, the influence on the market will be different according as funds are raised by means of Ways and Means advances from the Central Bank or by issuing Treasury Bills. The effect of Ways and Means advances is to enlarge the deposits of commercial banks, as disbursements made to the public return to them in the form of deposits. This enables the commercial banks to further enlarge their credit. Ways and Means advances are therefore generally resorted to for very short periods in anticipation of tax receipts or of funds to be raised by borrowing. The issue of Treasury Bills has the effect of depleting funds in the money market. It is therefore necessary to exercise caution in issuing them and to see that they are not put on the market at a time when conditions are stringent.

It is interesting to observe in this connexion that the heavy increase in the volume of Treasury Bills in England ever since the last Great War has had a deleterious effect on the position of internal commercial bills in that country. It has had the effect of making the overdraft more important in the London money market than internal commercial bills [2]. In answer to the question whether the enormous growth of bankers' deposits may not be due to a very large extent to the floating

[1] Grant, op. cit., p. 71.

[2] *Minutes of Evidence before the Macmillan Committee*, Qns. 467–71.

debt, Sir Ernest Harvey replied, in tendering evidence to the Macmillan Committee, that 'if it enables bankers to keep additional reserves of liquid assets such as call money which the market can invest in bills, it may give the bankers the power to create more deposits by advances '[1].

Government's Financial Operations and the Money Market in India

As in other countries, the financial operations of the Central and Provincial Governments in India are now conducted by the Reserve Bank through which their effects are exercised on the money market. It should be observed here that it is not possible to isolate these effects on particular markets, such as Bombay and Calcutta. For no information as to the extent of these operations in individual markets is available. Therefore the influence of Government operations on the money market will be examined as a whole.

Before describing the relationship between the Government and the Reserve Bank and between them and the money market, a few general observations may be made in reference to certain special circumstances that had until recently existed in India.

In all countries, the relationship between the Government and the Central Bank is intimate. Even in advanced countries like Great Britain, this was described as 'completely close and completely cordial '[2]. As to the actual relative position that should obtain between the Government and the Central Bank, there is some sort of a general agreement. It is generally conceded that the Central Bank should be allowed the maximum measure of independence in its actual working.

[1] Qn. 468.

[2] Sir E. Harvey's evidence before the Committee on Finance and Industry, Qn. 454.

De Kock[1] defines the relationship that should exist between the Government and the Central Bank in the following manner:

'The Government should be recognized as the ultimate authority responsible for laying down the monetary policy and the monetary standard of its country and the Central Bank as the party responsible for carrying out the monetary policy and maintaining the monetary standard, with the added responsibility of seeking to safeguard the national economic welfare to the best of its ability.'

In actual practice the relative importance of the Government and the Central Bank in their mutual relationship is largely dependent upon the conditions obtaining in particular countries. In England, for example, the Bank of England was till lately practically independent of Government control, although latterly the Treasury influence[2] on the Bank has been considerably increasing. As a matter of fact there has of late been a trend towards greater state participation in, and control over, Central Banks all over the world. In India there are historical reasons for very large influence being exercised by the Government. Until up to the constitution of the Reserve Bank, the Government exercised direct control over currency in general and over the note issue in particular. Thus its influence over monetary policy and conditions in the money market was direct. The requirements of the Government's remittance programme, which was directed by the Government, had intimate bearing on the exchanges and so on the money market. It is well known how in the earlier years the needs of the Government's finances and in particular its requirements of sterling resources in London to pay for the Home Charges not only invested the exchange question with undue

[1] *Central Banking*, p. 62.

[2] Dodwell: *Treasuries and Central Banks*, p. 205.

prominence but also exerted a deleterious influence from time to time on the currency and credit needs of the Indian money market.

With the establishment of the Reserve Bank, the direct influence of the Government on the money market has, at least in theory, been brought to an end. In practice, however, the Government's influence on the Reserve Bank and therefore on the money market must still be considerable. For, in addition to the historical reason, the Government has a large say in the constitution of the Central Board of the Reserve Bank. Further, the Governor as well as the Deputy Governors of the Reserve Bank are nominated by the Governor General in Council on the recommendations of the Central Board. The present Governor of the Reserve Bank, Sir James Taylor, was not only a member of the Indian Civil Service but also the Controller of Currency prior to the establishment of the Reserve Bank.

The Reserve Bank as Government's Bankers

As bankers to the Government, the Reserve Bank holds cash balances of the Governments, Central and Provincial. These balances contribute a large portion of the funds of the Reserve Bank as will be evident from the following table:

Average of Friday figures	In lakhs of rupees Total deposit	 Government balances
1937-38	36,92	11,42
1938-39	31,84	14,88
1939-40	32,68	13,75
1940-41	56,26	17,50

Prior to the establishment of the Reserve Bank, the state of Government balances with the Imperial Bank had considerable influence over conditions in the money market. As

a matter of fact, the movements of the Imperial Bank rates at that time or the then bank rate were often associated more with the loan operations and exchange policy of the Government of India and its balances with the bank than with the requirements of trade and commerce. Further, as the Imperial Bank had no responsibility for the supply of currency nor was it a true Central Bank, there was no urge on its part to maintain a large cash reserve in the slack season so as to meet the stringency in the busy season without unduly raising the bank rate. With the constitution of the Reserve Bank, however, these defects of the Indian money market have been removed. The influence of Government operations on the money market is now exercised, if at all, not by the state of the Government balances from time to time, but mainly in connexion with the borrowing needs and activities of the Government.

Government Borrowing and the Money Market

Government borrowings may affect conditions in the money market in two principal ways, viz., by diverting funds away from the market that would have been employed to assist trade, commerce or industry, and by affecting the rates of interest in the money market. Let us examine these two aspects in turn.

Government Borrowing and Diversion of Funds

. Government borrowing may be grouped under two categories, viz., permanent and floating debts. The term permanent debt covers all debt which at the time of issue has a currency of more than twelve months. It consists of rupee loans floated in India and sterling loans floated in England. The floating debt consists mostly of 'ways and means' advances and Treasury Bills.

Long-term borrowing has effect primarily on the capital market. The money market as such is not likely to be affected by such borrowing, although it has been maintained that, if Government 'borrows in the open market, money comes from the commercial centres, and trade and industry suffer as a result of financial stringency[1]'. There is no cogent reason why such a result should usually or at all ensue. In the first place, banks maintain a certain proportion of their assets in Government securities. This proportion is decided upon by bankers after due consideration of the conditions in which they operate, their need for easily realizable assets and the availability of alternative sources of investment. The amount for which a loan may be floated by a Government or small differences in interest yield are not likely to affect the proportion that banks consider they should keep invested in Government securities. The danger of any depreciation in the value of such securities is another deterrent to holding any larger portfolio of these securities than is considered necessary.

In the second place, in so far as investment in gilt-edged is concerned, a certain portion of the annual saving is seeking investment in these securities. It has been estimated that the annual savings earmarked in India for investment in gilt-edged only are of the order of Rs20 crores[2]. If the Government does not come on the market with new loans of more than Rs20 crores a year, no repercussions should be felt in any other section of the capital market. If the Government's demand for fresh money exceeds Rs20 crores it will strain the capacity of the gilt-edged market and may, particularly if the yield is attractive, affect other forms of long-term borrowing. For example, industry may find it more difficult to raise capital by means of public subscription of shares or debentures.

[1] Dubey: *The Indian Public Debt*, p. 294.

[2] *Indian Finance*, June 7, 1941, p. 1035.

The size of the floating debt effected through the instrument of Treasury Bills may be considered to affect conditions in the money market. For, if the Government should issue a very large parcel of Treasury Bills, it may be argued that banking funds may be locked up in such bills with consequent adverse effects on other genuine borrowers in the market. But even if banks did invest very large funds in Treasury Bills, there is no reason why their regular borrowers should suffer. For Treasury Bills are more in the nature of cash than short-term investments. They can be readily discounted with commercial banks or the Reserve Bank, so that a large portfolio of Treasury Bills should not restrict the lending capacity of commercial banks.

Government borrowings, whether long or short term, are not likely to affect the money market merely on account of their size. If, further, the technique of loan floatation is perfect, a much larger loan than may be ordinarily supposed to be within the capacity of the market to take up, may be absorbed by it without any evil effect.

Government Borrowings and Money Rates

Practically the only way in which Government borrowings may affect the money market is by reacting on its interest rates. If the Government is hesitant in its borrowing policy, and if, in addition, its technique is imperfect, it will probably offer higher interest rates than is necessary for its borrowings, and thus be responsible for raising the rates of interest charged to other borrowers in the market. In particular the rate at which industries will be able to raise fresh capital by means of shares or debentures will have to be raised. Thus weak and hesitant borrowing policy on the part of the Government may have the effect of increasing the price at which new capital may be secured by entrepreneurs from the public as

well as of enhancing the rate to be charged to other borrowers in the market. By adopting a sound loan policy the Government can help to lower the price of borrowed money and thus render a great service to the public. The technique of a sound loan floatation includes, when necessary, adroit open market operations. It is well known that the Government has at its disposal various funds which it can effectively utilize to assist its loan operations. The important sources of these funds are the post office, the railway reserve fund, the railway depreciation fund, provident fund and the debt redemption fund.

Government's Remittance Programme and Money Market

The obligation of the Government of India to put the Secretary of State in London in possession of funds to meet the Home Charges has in the past exercised a great influence on currency and credit conditions in India. The annual remittance on Government account amounted to a very large sum, and was about £35 millions in 1925, but declined in the years just prior to the present war to about £27 millions. The way in which this remittance was effected particularly up to the time the Hilton-Young Commission submitted its recommendation often had adverse effects on the Indian money market. One of the ways in which the funds of the Secretary of State in London were fed was by the sale of Council Bills. Council Bills or Telegraphic Transfers were sold by the Secretary of State in London for sterling offered in London payable in rupees in India. Council Bills were at times sold without any reference to conditions in India, or even to the requirements of the Secretary of State in London. Very large balances much in excess of the Secretary of State's requirements were often maintained in London, while Council Bills might have been

sold at a time when conditions in the money market in India were stringent. The Hilton-Young Commission therefore recommended that 'the Reserve Bank should be entrusted with all the remittance operations of the Government in India and in London. The Government will thus cease directly to operate in the exchange market'[1]. The Commission also expressed the opinion that the time and method of making these remittances had an important bearing on conditions in the market in India and added that 'the action of the Government by which in recent years part of the remittance first put through the treasury was subsequently put through the currency, shows that the Government cannot carry on its remittance operations irrespective of their effect on the Indian money market or currency policy'[2]. It was for this reason that the Commission recommended that the remittance programme should be operated by the Reserve Bank. This work has in effect been taken up by the Reserve Bank since its establishment. Further, the practice of selling Council Bills in London has also been discontinued, practically since 1925-26. Weekly tenders for the sale of sterling to be delivered in London are invited by the Reserve Bank in India. Since the outbreak of the present war, owing to the introduction of restrictions on exchange operations and the growing sterling balances in London, the practice of inviting weekly tenders has been temporarily discontinued.

The remittance programme of the Government has undergone great transformation since the present war broke out. Many factors have been responsible for huge accumulation of sterling balances in London. The most important of these are the restrictions on imports, owing primarily to the necessity for conserving foreign exchange, the increased expen-

[1] Para 103. [2] Footnote to para 103.

diture by the British Government in respect of the army in India by virtue of an agreement recently concluded with the British War Office, and the sterling credit which the Government of India obtain in respect of purchases they make for the British Government in the Indian markets, as well as of the other commitments which the Indian Government incur for the British War Office. The combined effect of all these factors on the remittance programme of the Government may be expressed thus:[1]

'For 1940-41 the original remittance programme was £11 millions. The revised estimate as furnished by Sir Jeremy Raisman, the Finance Member, last February was expected to be only £1 million for 1940-41. So far as 1941-42 is concerned far from the Indian Government having to make any remittances from India, they actually expect a refund of £26 million.'

This result, it should be recalled, has been achieved in addition to the recent redemption of the dated India Sterling loans.

The Post Office as a Banker

The post office, which performs, in addition to its primary function of conveyance of communications, many banking services, is a department of the Government. The main banking functions it performs are the accepting of deposits in its numerous savings bank offices and the provision of facilities for investment in post office cash certificates and the remittance of money from one place to another through money order and postal order systems.

The total savings bank deposits of the post office amounted at the end of 1937-38 to Rs8½ crores, since when there has been some decline chiefly after the outbreak of the war.

[1] *Indian Finance*, June 21, 1941, p. 1123.

In 1937-38 cash certificates issued and discharged amounted to Rs14 crores and Rs18 crores respectively. The question naturally arises whether the banking operations of the post office adversely affect commercial banks, particularly in the matter of attracting the savings of the public. It is unlikely, however, that any prejudicial influence should be exercised on the banks. For the post office generally caters to the needs of the small man who would not ordinarily avail himself of the services of a bank. Very often he is ignorant and probably also illiterate and the formalities and regulations to be observed in maintaining a banking account would generally not commend it to his favour. Further there are restrictions on the amounts that may be held with Post Office Savings Banks. For example, not more than Rs750 may be deposited in a year, and the total amount that can be held at deposit in an account must not exceed Rs5,000. Government securities purchased through the savings bank are not counted against the maximum deposit.

It is, therefore, not likely that any serious competition should exist between the post office and the commercial banks in the matter of attracting deposits from the public. Co-operative banks may, however, find the post office a serious competitor.

There is one way in which post office funds, obtained either through its savings banks or by the sale of cash certificates, may exercise some influence on the money market. These funds may be utilized by the Government for undertaking open market operations in Government securities through the agency of the Reserve Bank with such ends as imparting strength to the securities market or assisting Government loan floatations.

PART III

CHAPTER XV

THE LONG-TERM CAPITAL MARKET

It is usual to distinguish between the short-term money market and the long-term capital market. The distinction, however, is neither clear-cut nor complete. For one thing, operations in the one have sometimes their reaction on the other. Thus, when dividend or interest is paid on ordinary shares or debentures, preference shares and Government borrowings, it swells the funds in the short-term money market, although it is a result of operations in the long-term capital market. For another, the content of each of these markets would have been different in the absence of the other. Thus the absence of a machinery for the short-term financing of industry or the Government would have meant an increased pressure on the capital market.

In a very broad sense, therefore, the capital market may be said to 'consist of a series of channels through which the savings of the community are made available for industrial and commercial enterprise and for public authorities. It embraces not only the system by which the public takes up long-term securities directly or through intermediaries, but also the elaborate network of institutions responsible for short-term and medium-term lending'[1].

The expression 'capital market' is however not commonly used in this broad sense. Although it is realized that the working capital of industries which commercial banks finance is not always short-term credit inasmuch as it is understood that such accommodation will be continued from time to time by the banks after the expiry of the original period, yet the operations of commercial banks are generally excluded

[1] Grant: *A Study of the Capital Market in Post-War Britain*, p. 119.

from the scope of the capital market. The conception of the capital market is usually restricted to long-term investment. It will, however, be a mistake to confine it to investment in marketable securities only. For capital is raised in many other forms than through the instrument of marketable securities. In fact there are many types of investment in business which do not, at least readily, take a form that can be translated into securities which can be freely bought and sold. New enterprises in most countries do not come up on the securities market until their merit has been demonstrated by some years' working.

Although the capital market is primarily concerned with the long-term needs of industrial and commercial establishments and the government, there is another type of investment of varying importance in different countries which falls within the scope of the capital market. This refers to investments in real estate and buildings. Such investments are usually on an appreciable scale in growing metropolitan centres. They have certainly been of increasing importance in recent years in Calcutta and its suburbs. The outbreak of the War with its uncertain and fluctuating outlook on the fortunes of industry and commerce has served further to enhance the popularity of investments in real estate. Our study of the capital market may, therefore, be arranged under three broad heads, viz., long-term finance for industry, long-term finance for the Government and semi-public institutions, and investment in real estate and buildings. An attempt will also be made to estimate, however roughly the annual investment of the Calcutta capital market.

I. *Financing of industry*

The long-term capital requirements of industries have a two-fold significance according as they refer to established

or new industries. Let us first examine the case of new industries.

New Industries

There are various ways in which a new industry may be started. In the first place, new economic development may take place through the expansion or under the auspices of existing undertakings. Most established concerns build up large reserves, which they can utilize in expanding their existing businesses in new directions or in establishing new lines altogether. They also have financial connexions which they can exploit in raising capital for new expansions or industries. In India, the institution of managing agents deserves particular notice as an agency for undertaking new developments of existing industries or sponsoring new industries.

In the second place, where a new enterprise cannot depend upon the support of an established concern, the necessary capital, or a large portion of it, may be subscribed by those who are prepared to take a personal interest in it and face the risk of loss in return for prospective large profits. Once, however, a minimum capital has been raised, it can later be supplemented by credit obtained from banks or other financial institutions. As, under this system, the new enterprise has to depend primarily on private capital, it is generally started on a small scale. After it has achieved some growth and success, it can be converted into a public company and assured development on a larger scale. The private capital may be contributed either by the entrepreneur himself or by his friends, or by financiers on the look-out for large profits against corresponding risks of loss.

In the third place, new capital may be raised through the machinery of the Stock Exchange. Although the stock

market usually attracts great attention as a mechanism for obtaining new capital, its value to a new industry must ordinarily be insignificant. For it has been aptly said that the 'Stock Exchange is primarily an institution for imparting marketability to securities, only very secondarily is it an institution for providing new money for enterprise. It enables established enterprises to make their securities marketable, and, exceptional cases apart, a new issue means nothing more nor less than the sale of an existing enterprise to the public'[1].

In the fourth place, capital for a new industry may be raised by public or private subscription of shares. Shares of such industries are usually not quoted on the Stock Exchange. The method by which shares are offered for sale to the public may, however, vary considerably. In Great Britain, for example, shares may be issued to the public through the agency of such recognized issuing houses as Barings, Rothschilds, Morgan Grenfell, Schröders, Hambros, Erlangers, etc., or of a number of trust and finance companies, or what are described as ephemeral promoting groups, usually formed specially for the purpose of selling a venture to the public and dissolved when that purpose has been achieved. Associated with these three groups, which constitute the centre of the market organization, are others who specialize in some part of it, e.g., underwriters such as banks, trust and finance companies and other financial institutions, brokers, advertisement houses, etc. In contrast to the procedure which obtains in Great Britain, it may be mentioned that in Germany the sale of shares is undertaken primarily by the banks, while in France the task is shouldered mainly by the Haute Banque, the great Credit Societies and local

[1] Grant: op. cit., p. 128.

bankers. Only to a very limited extent, if at all, are shares sold to the public in these countries by the method of direct hawking.

A brief reference may be made here to certain developments in Great Britain since the last Great War in respect of institutional financing. They were inspired partially by the recommendations of the Macmillian Committee, and were in certain cases sponsored by the Bank of England. Thus the Bankers' Industrial Development Trust and the Securities Management Trust were established in 1930 and 1929 respectively under the auspices of the Bank of England, with the object mainly of salvaging depressed industries. The purpose of the former institution was to provide necessary finance for pushing through schemes of rationalization and reconstruction of such industries as ship-building, cotton and iron and steel, while the object of the latter was to take up and administer the industrial interests of the Bank of England remaining over from the period when the Bank did ordinary commercial banking business or which it had accepted in the national interest during the depression. Another important development has been in respect of instalment financing. The United Dominions Trust, the largest of such institutions, the Banking Facilities Trust and the Mercantile Credit Company specialize in hire-purchase and deferred-payment agreements. These companies assist new enterprise by financing the purchase of equipment and machinery on easy instalment payment system. The United Dominions Trust also set up a subsidiary company in 1934, entitled the Credit for Industry, with the object of providing the capital requirements of small businesses. Credit for Industry was started to make suitable loans to tradesmen, manufacturers, and others engaged in various forms of industry, requiring additional resources in semi-permanent form. Loans are

allowed against the security of mortgage or debenture for amounts ranging from £100 to £50,000, and are repayable within periods up to twenty years. This institution is not of any use to entirely new ventures, as it lends only against security. There are two other institutions for the provision of capital to small existing industries, viz., the Charter-house Industrial Development Company founded in 1934 by the Charter-house Investment Trust, and the Leadenhall Securities Corporation formed by Schröders in 1935. Among companies which to a certain extent also undertake participating business may be mentioned, the Lonsdale Investment Trust, and the Northern Territories Trust formed in Manchester with the object of handling local issues and providing finance to local industry. Lastly, the Special Areas Reconstruction Association, Ltd., formed to encourage business in depressed areas, deserves mention. It was formed for the purpose of providing additional capital to enable new industrial enterprises to be established or existing undertakings extended in the special areas. Applicants for loan are required to satisfy the Association that their businesses have reasonable prospects of eventual success and that they are not in a position for the time being to obtain adequate financial facilities from other sources.

The recent developments in institutional financing in Great Britain have only touched the fringe of the problem of financing new ventures. 'In general,' observes Mr Grant [1], 'it may be said that the facilities for any sort of business which already has something to show has very much increased. The real difficulties lie elsewhere, and affect the new and potential business. Here little is being done. Such business, as always, is still in the main dependent

[1] Grant: op. cit., p. 221.

on private individuals and groups who may be interested in proposals put before them.'

It is appropriate to describe here the differences that obtain in financing an absolutely new enterprise in India and in a western country like Great Britain. In Great Britain, it will be well nigh impossible for such a concern to obtain capital from the organized capital market. It will have to be financed in its early stages mainly by the entrepreneurs themselves, supplemented by what can be gathered from private sources, provided, of course, it has not been sponsored under the auspices of some established concern. When the initial capital, or a large portion of it, has been raised in this way, further assistance may be obtained from banks, hire-purchase companies and other financial institutions. After the concern has been nurtured for sometime in this fashion, it will then come up on the capital market for raising capital by means of shares or debentures. For it will then have some achievement to its credit to impart negotiability to its securities. Thus capital raised by new issues in Great Britain is used partly for taking over existing assets, and only partly for the provision of working capital and capital for expansion in future.

In India, conditions are materially different. There are no institutions, properly speaking, of the new issue market to sponsor the sale of shares or debentures to the public. Underwriting of new issues is an uncommon phenomenon in this country. One reason why underwriting is not common is the prevalence of the managing agency system. As, generally speaking, managing agents themselves supply the necessary finance when they sponsor any new undertaking, the practice of underwriting shares in this country is of much less importance. When new issues are underwritten, this is done practically by stock-broking firms only. In Bengal there have been recently a few cases where reputed stock-brokers

have underwritten the shares of companies. Messrs Place, Siddons and Gough, for example, underwrote a large block of shares of the Indian Malleable Castings, Ltd.; Rohtas Industries, Ltd., and the Ramnugger Cane and Sugar Co., Ltd.; Messrs Stewart & Co. and Narayandas Khandelwal & Co. underwrote the entire public issue of the Calcutta Safe Deposit Co., Ltd. In the absence of agencies for sponsoring new issues, and where necessary finance is not provided by managing agents, new companies have generally to raise capital by offering shares and debentures to the public for sale by means of public advertisement. Of shares and debentures, the latter has but a limited market in India. The Central Banking Enquiry Committee refers [1] to certain practical and psychological difficulties which have militated against the financing of fixed capital expenditure by means of debentures. Experience, however, shows that when the security behind the debentures is very sound, there has been no lack of response from the investing public. Thus debentures issued by companies managed by reputed firms of managing agents, as in the case of jute mills, have been readily taken up by the public. In the case of new or recently started undertakings, debentures as a means of issuing capital are of little value, unless, of course, their interest or principal or both are guaranteed by public authorities. Thus, the Madras and Bombay Land Mortgage Banks have raised considerable capital from the public by means of debentures guaranteed by their respective governments. Up to the 30th June, 1940, the Central Land Mortgage Bank of Madras had floated debentures guaranteed by Government for principal and interest to the extent of Rs2,64 crores, of which Rs1,95 crores were outstanding on that date. The Bombay Provincial Co-operative Land Mortgage Bank, Ltd. had deben-

[1] Report, pp. 273–75.

tures of Rs.30 lakhs, guaranteed by Government for principal and interest, outstanding on the 30th June, 1940. It may be mentioned here that the technique of land-mortgage banking in other provinces is but inadequately developed. Bengal, for example, has five land-mortgage banks all financed by the Provincial Co-operative Bank. In contrast to in Bombay or Madras, there is no apex land-mortgage bank in Bengal.

As new or newly established concerns cannot generally expect to raise capital by means of debentures, they have to depend mainly upon public sale of shares for obtaining necessary long-term capital. It is a peculiar feature of the Indian capital market that even absolutely new concerns raise a large volume of capital from the market by the sale of shares. This is done mostly by direct hawking of shares to the public through the intermediary of agents who may be paid a fixed salary by the company concerned or, what is usually the case, a commission on sales. As the investors have nothing tangible to go by in purchasing the shares of a new company, the composition of the Board of Directors plays an important rôle in imparting marketability to its shares. Knowledge of actual achievements of the company concerned, which is evidently lacking, is replaced by the degree of confidence inspired by the composition of the Board of Directors in the public mind. A company with a strong Board of Directors, consisting of persons of wide and proved business integrity and experience, should find no difficulty in raising sufficient capital from the market, even though it should be entirely new. An unfortunate consequence is that even really good propositions may evoke no, or but inadequate, public support, if they are not backed by a well-known body of persons on their Boards as Directors.

The circumstance by which even entirely new concerns in India may raise capital from the market, although somewhat

novel, has solved, however unsatisfactorily, a difficult problem which industrialists have to face in this country. This problem has two facets. On the one hand, there is the absence of any recognized institutions in the new issue market. On the other, there is the comparative poverty of the population and the absence of many individuals with large wealth. The second trait makes it extremely difficult for new concerns to collect sufficient capital privately from a few individuals only. Under the circumstances, public offering of its shares for sale is about the only method available to even an entirely new concern for raising the necessary capital.

Established Industries

Established concerns may require new capital either for expansion or new development. They may finance either expansion of their existing businesses or new developments in various ways. In the first place, they may do so by drawing upon the accumulation in their reserve funds. In the second place, they may issue fresh calls for the unpaid portion of their share capital in accordance with the conditions prescribed for issuing such calls. In the third place, they may enlarge their share capital by the issue of fresh shares, ordinary or preference, or debentures. If they are well-established concerns, and specially when managed by reputed firms of managing agents, the machinery of the Stock Exchange should assist them in the sale of their shares or debentures. In the fourth place, indigenous bankers and private financiers sometimes lend long-term capital against the security of fixed capital. In the fifth place, and particularly for smaller concerns, there are certain other agencies which supply long-term capital. Two of these deserve mention in Bengal. They are the Bengal State Aid to Industries Act and the Industrial Credit Syndicate, Ltd. Their functions and usefulness may

be briefly described, particularly in view of the great importance of small and medium-sized industries in the economy of Bengal.

The Bengal State Aid to Industries Act [1] was passed in 1931, but, curiously enough, it did not begin to operate until 1933. The provisions of the Act are sufficiently wide. Thus, it not only provides for the grant of secured loans, guarantee of cash credits, overdrafts and fixed advances, the taking of shares and debentures and guarantee of a minimum return on the whole or part of the capital of a joint-stock company, but also provides for the guarantee of interest on preference shares and debentures and for the supply of machinery on the hire-purchase system. The main purpose of the Act, according to the *Administration Report of the Department of Industries, Bengal*, for 1932-33, is 'to foster the development of small and cottage industries'.

Not much use has in practice been made of the facilities provided by the Act. This will be borne out by the following figures [2] of loans applied for and sanctioned under the Act:

	Applications received	Total amount applied for	Applications entertained	Amount sanctioned	Applications rejected, abandoned or withdrawn	Amount rejected, abandoned or withdrawn
		Rs		Rs		Rs
1933-34	13	6,44,000	1	6,000	12	6,38,000
1934-35	28	1,39,800	3	2,600	25	1,37,200
1935-36	28	1,29,001	8	23,125	20	1,05,876
1936-37	40	5,55,350	16	22,700	24	5,32,650
1937-38	26	76,975	7	13,600	19	63,375
1938-39	50	2,39,600	18	26,050	32	2,12,550
1939-40	41	2,14,895	6	12,000	12	15,470

[1] For a short critical description of the Act, see *Industrial Finance in India* by S. K. Basu, pp. 215–220.

[2] Compiled from *Annual Report of the Board of Industries, Bengal*, 1939-40.

In respect of 1939-40, it should be mentioned that a large number of applications had not been disposed of. Four applications totalling Rs19,700 had been recommended to the Government for sanction, while 19 applications aggregating a value of Rs1,67,725 were still pending.

In the course of seven years up to 31st March, 1940, 59 applications aggregating a value of Rs1,06,075 were entertained by the Government under the State Aid to Industries Act. The average amount sanctioned per application is roughly Rs1,800, which is indicative of the fact that the applicants are mostly engaged in cottage or very small industries. A study of the objects for which loans were applied for reveal that the majority of applicants want funds for pursuing such occupations as hand-loom weaving, silk weaving and reeling, pottery manufacture, umbrella making, dyeing and weaving, lock-manufacturing, shoe-making, washing soap manufacturing, etc.

The meagre results achieved by the passing of the Act are ascribed to numerous causes. There is, for instance, the fundamental criticism that a governmental machinery is unfit for the administration of financial assistance to industries. Its red-tapism is inconsistent with the need for quick decision and speedy disposal of matters which are vital to industrial concerns. It is also a significant phenomenon that the administration of a State Aid to Industries Act, whether in India or abroad, e.g., in Columbia in Canada and the States of Victoria and South Australia, has not proved a success. Apart from this fundamental objection, the Bengal State Aid to Industries Act suffers from certain other specific defects. In the first place, the procedure for obtaining loans is cumbersome. Although the Act does not provide for any public advertisement of applications for loans, the Rules framed under it provide that every application for aid, whether

subsequently to be accepted or rejected, must be advertised in the Calcutta Gazette and the daily newspapers. No concern would welcome such public advertisement of its position and requirements. It is the essence of the financial relationship obtaining between a bank or a financial institution and its customer that it should be treated as confidential. The Government, if it really intends to render financial assistance to certain industries under the Act, should establish some machinery by which it can obtain relevant informations about an applicant by means of private enquiries. Secondly, applications for loans are subject to too strict a commercial scrutiny in order to satisfy the Rules framed under section 19. It is not suggested that loan proposals should not be carefully examined. What, however, is suggested is that they should be sympathetically considered. Not only the present financial position of the applicant but also his future prospects should be given adequate consideration. That a loan application should at all have been made is indicative of a need for either long-term capital or even of short-term capital under conditions which commercial banks would not probably consider absolutely safe. If Government should be guided in granting loans under the Act by the same considerations as would be proper for commercial banks, obviously there was no point in passing the Act. It is, therefore, desirable that the provisions of the Act should as far as possible be liberally interpreted. Thirdly, the Board which administers the Act has been vested with very limited powers. The Act or the Rules framed under it lay down detailed instructions as to the nature of security that has to be offered or the margin that has to be maintained, with the result that the Board can exercise little or no discretion in disposing of loan applications. Fourthly, the Board has to depend for funds on annual

allotments from the Budget, which may vary from year to year. This is a serious handicap to any planned work on the part of the Board. Fifthly, there is an unusual delay in disbursement of loans owing to the necessity of satisfying a wide range of rules. In fact, loans granted have at times been declined on the ground of inordinate delay. If the Bengal State Aid to Industries Act is to fulfil the purpose for which it was enacted, it should be shorn of the short-comings mentioned above, be more liberally interpreted and made more elastic in its administration.

The Industrial Credit Syndicate was established in March 1937 at the instance of the Government of Bengal with the object of supplying the long-term financial needs of small industries, to be started in particular by ex-detenues trained under the Unemployment Relief Scheme. The Government offered the Syndicate certain especial facilities in order presumably to enable it to undertake the risks of long-term advances to such industries. These especial facilities included among others the following:

(*a*) The amount properly expended by the company in administration expenses in each of the first five financial years of the company, or a contribution of twenty thousand rupees towards those expenses in each of the years, whichever is less.

(*b*) The payment by the Government from time to time to the Company (i) of sums equal to one-half of any losses of capital attributable to the first ten lakhs of rupees lent by the company; (ii) of sums equal to one-half of any losses of capital attributable to any amount lent by the company after and in addition to the first ten lakhs of rupees, provided that the capital sums covered by these subsequent

loans in origin formed part of the said sum of ten lakhs of rupees.

In addition to supplying the financial needs of small industries, particularly of those started by youngmen trained under the Unemployment Relief Scheme, it was also contemplated that the Syndicate should undertake the supervision of industries financed by it, provide technical advice, where necessary, and maintain an organization for the purchase of raw materials needed and the sale of finished goods manufactured by such industries. Unfortunately, in spite of the very liberal terms offered to it by the Bengal Government, the Syndicate has proved a failure in actual working. By the end of the financial year 1938-39, the total capital of the Syndicate was only Rs1,52,170 and the total amount of loan advanced Rs87,094-6-3. Loans were offered to only 19 parties against the security of machinery, stock-in-trade and personal guarantee of the borrowers. The rate of interest charged was 6 per cent. These figures bear clear testimony to the very poor results attained by the Syndicate. The terms offered by the Government indicate that it was expected that the Syndicate would advance loans up to about Rs10 lakhs, whereas the amount actually advanced was less than one lakh of rupees. Early in 1942, the agreement between the Industrial Credit Syndicate and the Bengal Government was determined on the ground that the Syndicate had at a meeting of its shareholders effected a vital change in the underwriting clause of its Articles of Association without prior consultation with or approval of the Bengal Government. The Government of Bengal have no longer any responsibility or liability in respect of the Industrial Credit Syndicate.

Neither the Industrial Credit Syndicate nor the Bengal State Aid to Industries Act has been of much practical value

for the provision of the long-term capital needs of even small or medium-sized industries; while no satisfactory machinery or agency exists in Bengal, or in any other province, for financing the long-term capital requirements of the larger industries. The only fruitful method of obtaining long-term capital for industries is by means of public subscription of shares or debentures whether through the machinery of the Stock Exchange, or, as more often, by direct canvassing. An estimate of the capital increased or new capital subscribed during each of the following years in respect of companies registered in Bengal is given below:

Capital increased during the year

	In thousand rupees
1920-21	15,53,56
1925-26	3,68,96
1930-31	4,10,44
1935-36	2,88,66
1936-37	3,51,48
1937-38	4,49,48
1938-39	6,74,00

These figures do not take account of shares or debentures subscribed to by the public in Bengal in respect of companies not registered in Bengal. But, as against this, they include such shares and debentures as have been purchased outside Bengal in respect of companies registered in Bengal. It should also be added that the activities in the Calcutta market alone is not responsible for the contribution of the whole of the increased capital every year. For shares and debentures are sold by direct canvassing in moffussil areas also. Nevertheless, the Calcutta market is undoubtedly the most

important source for the financing of new capital of industries. Apart from the exceptional year of 1920-21, the average amount of new capital raised in Bengal per year appears to be between Rs4 to 5 crores in a normal year. Incidentally, it may be mentioned that the amount of capital decreased per year in respect of companies registered in Bengal averages between Rs50 to 60 lakhs, as the following table will reveal:

Capital decreased during the year

			In thousand rupees
1920-21	..	..	4,36
1925-26	..	..	90,85
1930-31	..	..	38,89
1935-36	..	..	40,94
1936-37	..	..	61,22
1938-39	..	..	76,93

Investment Intermediaries

In Great Britain and America, there are certain institutions which invest large funds in securities of various types, and thereby also assist industries in obtaining long-term capital. They perform the beneficial service of linking up savers, especially small savers, at one end of the chain with borrowers of capital, at the other. It should be noted that industrial securities held by these institutions are usually of established concerns, so that their operation offers little or no help to entirely new ventures.

Important among these investment intermediaries are banks, insurance companies, investment trusts, building societies, and large business establishments. Commercial banks, however, are not important as suppliers of long-term

capital. They usually provide the short-term working capital of industries, and what securities they purchase are usually Government securities. In Great Britain[1], insurance companies, investment trusts and building societies invest large funds in industrial securities. In 1934 in Great Britain, between a quarter and a third of the total invested funds of insurance companies amounting to about £1,500 millions consisted of securities in railway companies and industrial and commercial enterprise. Some thirty to forty per cent of the investments of the Investment Trusts in Britain were in ordinary shares. In 1934, their total security holding was about £350 millions. Building societies and business concerns also invest large funds in stock exchange securities. In spite of these investment intermediaries, however, the private holder of securities is still much more important in Great Britain.

In India, investment intermediaries play, comparatively, a much inferior rôle and the private holder of securities is much more important. Indian insurance companies have a large security holding, but these securities are mostly government or semi-government securities. This tendency of investing insurance funds in government or semi-government securities has been further strengthened by the enactment of the new insurance legislation, under which 55 per cent of the assets of insurance companies have to be invested in government and semi-government securities. In 1937, between six and seven per cent only of the total invested funds of about Rs55 crores was invested in shares of industrial companies. In 1940, out of a total asset of Rs77 crores, only Rs5 crores or a little over six per cent were invested in shares of industrial

[1] For a description of their operation in Great Britain, see Grant: op. cit., Ch. XI.

companies. Building societies, properly so-called, are practically non-existent in India, while the holding of industrial securities by private business concerns will not amount to much. There are in India about half a dozen investment companies, all small-sized, and not all of which can be accurately described as investment trusts. Four of these companies are in Calcutta. The objects for which the companies were established are as follows:

Name	Object
1. Birds Investment, Ltd., Calcutta, 1936.	To invest the monies subscribed by shareholders in the shares and debentures of companies particularly those connected with businesses and industries in which the firms of Bird & Co. and F. W. Heilgers & Co. are interested.
2. General Investment & Trust Co., Ltd., Calcutta, 1908.	To invest the monies subscribed by shareholders in the shares of carefully selected companies and in securities of the Government of India or Municipal or Port Trust Debentures and to transact business as capitalists and financial and monetary agents.
3. Investment and Finance Co., Ltd., Calcutta, 1935.	do
4. New India Investment Corporation, Ltd., Calcutta, 1936.	do
5. Industrial Investment Trust, Ltd., Bombay, 1933.	To invest the monies subscribed by the shareholders in the shares of carefully selected companies.
6. Hindusthan Investment and Financial Trust, Ltd., Madras, 1936.	To invest the funds of the Company in shares and securities of carefully selected companies and to carry on business as a General Investment Trust Company

Some idea of the importance of these investment companies may be had from the figures (given overleaf) extracted from their balance sheets.

Name	Year ending	Capital	Reserve	Investments	Liquid assets
		Rs	Rs	Rs	Rs
1. Birds Investment, Ltd. ..	30-9-1941	30,00,000	40,000	36,94,413	81,953
2. General Investment & Trust Co., Ltd. ..	31-8-1941	2,50,000	55,000	3,21,060	15,013
3. Investment & Finance Co., Ltd.	31-8-1941	4,50,000	2,60,000	7,47,496	29,967
4. New India Investment Corporation, Ltd.	31-12-1940	23,32,000	1,90,000	25,38,493	2,78,799
5. Industrial Investment Trust, Ltd.	31-12-1940	50,00,000	4,25,000	55,58,612	1,57,047
6. Hindusthan Investment & Finance Trust, Ltd.	30-6-1941	2,50,000	56,750	3,51,260	24,960

The total investment of all these companies is about Rs132 lakhs, and of the four Calcutta companies a little over Rs73 lakhs. Quite a large proportion of this amount is accounted for by government and semi-government securities, so that holdings of industrial securities are comparatively small. There can be no question that in India the private holder of industrial securities is far more important than the institutional holder.

II. *Investment in government and semi-government securities*

Public Debt in India

The total public debt of India since 1938-39 is shown in the table on pp. 280-81.

Of the total public debt of Rs1,186,16 crores in 1938-39, the permanent debt amounted to Rs882,73 crores, floating

debt to Rs46,30 crores, unfunded debt to Rs229,31 crores and depreciation and reserve funds to Rs27,82 crores. Of the permanent debt of Rs882,73 crores in 1938-39, rupee debt and sterling debt accounted for Rs417,79 and Rs464,94 crores respectively. There has, however, been some material change in the composition of the public debt of India since 1938-39. Thus, although the estimated total and permanent public debts of India during 1942-43 at Rs1,227,43 and Rs846,45 crores respectively, do not vary greatly from the figures of 1938-39, the composition of the estimated permanent debt during 1942-43 has substantially altered. Of the estimated permanent debt of Rs846,45 crores in 1942-43, Rs732,93 crores are accounted for by rupee debt and the balance of Rs113,52 by sterling debt. Whereas in 1938-39, the sterling debt was more than the rupee debt, it is only about 15 per cent of the rupee debt in 1942-43. This change in the composition of the permanent debt of India is the result of the policy initiated by the Government of India in 1940 of repatriating India's sterling debts.

In addition to the Government of India, Provincial Governments also raise loans from time to time. The total permanent debt of all the Provincial Governments is detailed below:

	Rs (lakhs)
1937-38	12,64
1938-39	15,07
1939-40	19,61
1940-41	23,90

Estimate of the annual investment of the Calcutta Market

It is extremely difficult to form an estimate of the likely annual investment of the Calcutta market in loans floated by Governments, Central or Provincial, or semi-public

Interest-bearing obligations of the Government of India

(In crores of rupees)

	1937-38	1938-39	1939-40	1940-41	1941-42 (Revised Estimate)	1942-43 (Budget Estimate)
In India—						
Public Debt—						
Loans	436,40	417,79	450,23	574,55	633,33	732,93
Treasury Bills and Ways and Means Advances	30,01	46,30	54,70	84,90	84,90	114,40
Total Public Debt ..	476,41	464,09	504,93	659,45	718,23	847,33
Unfunded Debt—						
Service Funds	1,07	1,03	97	94	90	87
Post Office S.B.	77,55	81,88	78,32	59,51	52,46	50,35
Post Office Certificates ..	60,21	59,57	57,03	49,28	44,58	42,08
State Provident Funds ..	69,68	72,40	75,22	78,03	81,07	84,42
Other Items	9,65	10,25	10,70	11,15	11,48	11,86
Total Unfunded Debt ..	218,16	225,13	222,24	198,91	190,49	189,58
Deposits—						
Depreciation and Reserve Funds	22,78	27,82	33,47	44,38	59,88	73,29
Total Obligations in India ..	717,35	717,04	760,64	902,74	968,60	1,110,20

In England—						
Public Debt—						
Loans	396,75	396,50	373,46	278,37	177,10	56,90
War contribution	20,62	20,62	20,62	20,62	20,62	20,62
Capital portion annuities created in purchase in railways	50,52	47,82	45,02	42,12	39,11	36,00
Total Public Debt	467,89	464,94	439,10	341,11	236,83	113,52
Unfunded Debt—						
Service Funds	11,92	4,18	4,12	3,82	3,77	3,71
Total Obligations in England	479,81	469,12	443,22	344,93	240,60	117,23
GRAND TOTAL	1,197,16	1,186,16	1,203,86	1,247,67	1,209,20	1,227,43

Sterling debts have been converted into rupees @ 1*s*. 6*d*. per rupee.

institutions like Corporation and Port Trust, as relevant data are not available. A rough estimate may, however, be attempted on the following lines.

(*a*) India Government Loans.—The loans issued since 1937 are as follows:

Amount (Rs)	Interest %	Date of Issue	Repayable on
60,89,64,000	3	May 1938	1963–65
15,00,00,000	3	July 1939	1963–65
45,14,31,000	3 (Defence Bonds)	On and from June 1940	
3,53,57,000	Interest free	On and from June 1940	
38,91,53,000	3 (Defence Bonds)	January 1941	

No statistics are usually available as to the proportion of these loans contributed by particular money markets. Since the floatation of defence loans, figures have been published from time to time of the proportion of defence loans subscribed to by the different provinces and Indian States. The statistics on the opposite page for the month of June 1942 will be found interesting.

These figures reveal that Bombay and Bengal have subscribed by far the largest bulk of these loans. Between them they are responsible for the purchase of about 77 per cent of the total amount of defence loans and certificates subscribed by the end of June 1942. The share of Bengal is slightly higher than that of Bombay, which may at first appear surprising. For most of the big banks and insurance companies, which constitute important buyers of gilt-edged securities, are located in Bombay. As against this is to be set off the fact that Calcutta is the most important market for small private holders of these securities. Thus, apart from any argument that may be put forward that subscription to defence loans is no index to the subscription to other government loans, it may be assumed that Bombay and Bengal between

In thousands of rupees

Area		3% Defence Loans	Interest Free Bonds	Defence Savings Certificates	Defence Savings Bank	Grand Total
Bengal	..	40,74,14	38,83	78,16	1,77	41,92,90
Bombay	..	37,55,66	1,22,84	80,68	2,39	39,61,57
Punjab	..	5,10,84	16,58	57,07	2,84	5,87,33
U.P.	..	4,38,96	10,90	66,57	2,81	5,19,24
Madras	..	4,21,98	5,53	31,26	79	4,59,56
Sind	..	1,30,56	3,34	14,74	61	1,49,25
Bihar	..	90,47	5,55	33,99	51	1,30,52
Delhi	..	72,00	2,05	7,44	29	81,78
C.P. and Berar	.	30,00	1,38	20,51	40	52,29
N.W.F.P.	..	23,74	1,30	6,33	21	31,58
Orissa	..	27,35	6	3,52	4	30,97
Baluchistan	..	17,04	57	3,55	27	21,43
Assam	.	11,03	20	7,44	27	18,94
Ajmer-Merwara	..	8,94	18	1,57	3	10,72
Coorg	..	2	..	15	†	17
Indian States and other Central Treasuries	..	2,57,99	67,75	35,69	1,11	3,62,54
Total	..	98,70,72	2,77,06*	4,48,67*	14,34*	1,06,10,79*

Includes subsequent adjustments of previous preliminary figures.
† Subscription less than Rs500.

them purchase about 80 per cent of any loan floated by the Central Government, the share of each being roughly half and half. On this basis, of the 15 crores of 3% loan floated in 1939, the share of the Calcutta market would be about Rs6 crores.

(*b*) Provincial Government Loans.—The Government of Bengal have not raised any loans from the market. Some other Provincial Governments have floated long-term loans in the market, but no statistics are available as to the amount of these loans subscribed by Bengal.

(*c*) Loans floated by semi-public institutions.—The following loans have been issued in Bengal since 1937:

	Amount	Interest %	Date of Issue	Payable on
(i) Calcutta Corporation Debentures—				
	3,11,400	3	1-7-1937	1-9-1954
	4,67,100	3	1-9-1937	1-9-1954
	1,62,500	3	1-11-1937	1-11-1954
	4,18,000	3	1-12-1937	1-12-1954
	47,50,000	3	1-6-1938	1-6-1968
	10,67,600	3	1-12-1938	1-12-1955
	15,56,800	4	1-11-1939	1-11-1956
	15,56,800	4	1-12-1939	1-12-1956
	15,56,800	4	1-10-1940	1-10-1957
(ii) Calcutta Port Trust Debentures—				
	1,25,00,000	3	1-10-1937	1-11-1951
	25,00,000	3	1-6-1938	1-6-1968/98
(iii) Commissioners for the New Howrah Bridge—				
	1,50,00,000	$3\frac{1}{4}$	20-8-1936	20-8-1956/66
	1,50,00,000	$3\frac{1}{4}$	20-9-1937	20-8-1956/66
(iv) Calcutta Improvement Trust Loans—				
	50,00,000	3	30-7-1937	30-7-1962
	50,00,000	3	13-9-1938	13-9-1963/68

Although these loans were floated in Bengal, some portion of them must have been subscribed by other provinces. As against this, Bengal must have purchased some portion of such loans floated in other provinces. It may be assumed, however, that these two items would nearly cancel each other. In 1939, the only loans floated in Bengal by semi-public institutions were the Calcutta Corporation Debentures to the extent of Rs31,13,600.

In 1939 new investment of the Calcutta market in Government and semi-government securities would appear to be Rs6 crores in 3% Government of India loan plus Rs31 lakhs in Calcutta Corporation Debentures. If, however, it is assumed that the annual savings earmarked in India for investment in gilt-edged are of the order of Rs20 crores [1], and further that the Calcutta market is responsible for about 40 per cent of such investments, then its share alone would be about Rs8 crores. For the year 1939, therefore, it may be presumed that the Calcutta market will have invested about Rs1,70 crores in loans floated by other Provincial Governments.

III. *Investment in Real Estate and Building*

Long-term investment in land and building is of considerable magnitude in normal times, particularly in growing metropolitan cities; and has assumed even greater importance during the War. In the uncertainties created by the War the public has become so panicky that in its search for safe investment, it has turned increasingly to land and precious metals.

In our country there are no institutions of any importance for financing house-building or the purchase of real estate. Building societies properly so-called are conspicuous by their absence.

In Bengal only two companies deserve some mention, viz., the Ballygunge Bank, Ltd. and the Midnapore Zemindary Co., Ltd. The former does not deal with current or saving accounts or with commercial banking. It carries on the business of a building society and land development company

[1] See p. 250 above. This figure has greatly increased since the outbreak of the War. During the two years, 1940 and 1941, new investment in gilt-edged has been over Rs100 crores or more than Rs50 crores per year.

in Calcutta. On 31-12-40, its capital, reserve fund and deposits were Rs4,05,000, Rs40,000 and Rs12,38,000 respectively, while its investments in land and buildings stood at Rs13,75,000. The operations of the Midnapore Zemindary Co. are confined outside the Calcutta area. It owns zemindaries situated in the districts of Nadia, Rajshahi, Pabna, Malda, Murshidabad, Midnapore and Manbhum, having a total acreage of about 15,50,000 acres. On 13-4-41, its capital and reserves were Rs103 lakhs and Rs27 lakhs respectively, while its investments in block stood at Rs98 lakhs.

There is also no provision in this country, as in England, for the grant of Government subsidies either to local authorities or private agencies for building new houses. Agencies are, therefore, lacking in our country which would be interested in publishing figures of new houses built—figures, which could help us in estimating the total capital invested in new constructions. In India the necessary finance for purchasing land or erecting new constructions is provided mostly by private individuals, and only very partially by such public institutions as insurance or other financial companies.

Some idea of the annual investment in land and buildings in Bengal may be obtained from figures published by the Registration Department of the Government of Bengal. Among other statistics the Department publishes figures of the value of immovable property transferred by registered instruments. These figures from 1938 to 1940 for the whole of Bengal are given on page 287 [1].

These figures bring out the substantial increase in investments in immovable property since the War started. Compared to 1938, the increase in 1939 and in 1940 is about 25 and 34 per cent respectively.

[1] *Triennial Report on the Working of the Registration Department of the Government of Bengal*, 1938–1940.

Compulsory registrations affecting immovable property

	Aggregate value of sale or exchange of any value	Aggregate value of mortgage	Total value
	Rs	Rs	Rs
1938 ..	9,05,65,312	3,64,29,841	12,69,95,153
1939 ..	12,60,46,593	3,25,37,405	15,85,83,998
1940 ..	14,30,90,920	2,54,99,817	16,85,90,737

These figures of investments in immovable property for the whole of Bengal do not have much bearing on the working of the Calcutta capital market only. For, a very large portion of these investments are in rural areas. In so far as the capital market in Calcutta is concerned, investments in Calcutta and the 24-Parganas should be taken into account. The value of these investments are as follows [1]:

Compulsory registrations affecting immovable property

	Aggregate value of sale or exchange of any value		Aggregate value of mortgage		Total value
	Calcutta	24-Parganas	Calcutta	24-Parganas	Total
	Rs	Rs	Rs	Rs	Rs
1938 ..	1,76,12,269	2,00,09,102	80,27,594	73,13,957	5,29,62,922
1939 ..	1,96,54,575	2,03,02,242	1,14,63,899	54,28,194	5,68,48,910
1940 ..	2,30,08,535	2,55,51,634	55,80,158	41,37,398	5,82,77,725

A noteworthy feature of these statistics is that Calcutta and its suburbs, the 24-Parganas, or what we may call 'Greater Calcutta' account for over one-third of the total annual investment in immovable property for the whole of Bengal.

The statistics published by the Registration Department refer only to such investments in land and building as have been sold, exchanged or mortgaged. They do not, therefore, include new buildings built or new improvements to existing

[1] *Triennial Report on the Working of the Registration Department of the Government of Bengal*, 1938–1940.

structures effected unless, of course, they have been sold, exchanged or mortgaged during the same year. Enquiries reveal that only a small portion of new constructions erected during a particular year is either sold or mortgaged during the same year, and that it would not exceed ten per cent of the total new constructions during any year. To obtain, therefore, a total estimate of investments in both real estate and new buildings, an assessment of the annual value of new buildings constructed and new improvements effected to existing buildings is necessary. Unfortunately, no statistics are available which could indicate the probable annual value of new constructions during any year. An estimate of the annual value of new constructions within the Corporation of Calcutta has been obtained through the courtesy of the Assessor, Calcutta Corporation. Building construction has also been on a fairly large scale in the suburban municipalities of Calcutta during recent years. The amount annually invested in such construction should also be included in the total annual investment of the Calcutta capital market. No estimate of this amount could be obtained from any source. But it can be reasonably assumed that the total value of new construction in all the suburban municipalities of Calcutta taken together in any year would not exceed ten per cent of the total value of new constructions within the Corporation of Calcutta during the same period. The annual value of new constructions in the suburban municipalities of Calcutta, which should have been included in the total annual investment of Calcutta capital market, may therefore be offset against the annual value of new constructions within the Corporation of Calcutta which may have already been included in the figures provided by the Registration Department of immovable property sold or mortgaged. These two items may be considered to cancel each other, and the total annual

value of new constructions and new improvements within the jurisdiction of the Calcutta Corporation may be included in our computation of the annual investment of the Calcutta capital market. Relevant figures [1] since 1936-37 are quoted below:

Intermediate Revaluation from 1936-37 to 1941-42

Year	Previous Valuation	Revised Valuation	Increase
	Rs	Rs	Rs
1936-37	18,33,361	31,34,654	13,01,293
1937-38	16,79,578	28,89,966	12,10,388
1938-39	12,48,631	25,48,047	12,99,416
1939-40	10,80,768	24,91,207	14,10,439
1940-41	15,84,751	27,07,810	11,23,059
1941-42	11,84,551	21,63,626	9,79,075

	1936-37	1937-38	1938-39
	Rs	Rs	Rs
	13,01,293	12,10,388	12,99,416
Less, 10% for increase in valuation of land ..	1,30,129	1,21,038	1,29,941
	11,71,164	10,89,350	11,69,475

	1939-40	1940-41	1941-42
	Rs	Rs	Rs
	14,10,439	11,23,059	9,79,075
Less, 10% for increase in valuation of land ..	1,41,043	1,12,305	97,907
	12,69,396	10,10,754	8,81,168

Cost of Additional Buildings

1936-37	2,34,23,280
1937-38	2,17,87,000
1938-39	2,33,89,500
1939-40	2,53,87,920
1940-41	2,02,15,080
1941-42	1,76,23,360

The method adopted here for estimating the value of new constructions is as follows: Valuations referred to in the table are annual valuations of holdings, which are equivalent

[1] These figures were kindly supplied to the author by Mr. D. N. Ganguli, Assessor, Calcutta Corporation.

to five per cent of their total value. Revised valuation means the annual valuation of holdings after new constructions or improvements have been effected. Previous valuation means the annual valuation of the same holdings before any buildings had been erected on or improvements effected to them. The difference between the two valuations for any year indicates the increase in the annual valuation due to new constructions or improvements. As in the valuation of holdings both land and building are included, 10 per cent has been deducted for any increase in the valuation of the land only since the time of the previous valuation. The resulting figure gives us the increase in the annual valuation that can be attributed only to new constructions and improvements. As the annual valuation is only five per cent of the total value, the latter is obtained by multiplying twenty times the figure for annual valuation.

The total new investment of the Calcutta capital market for the year 1939 may be estimated as follows:

Investment in industries	Rs7 crores.
Investment in government and semi-government securities	,, 8 ,,
Investment in land and building (Rs5,68 +Rs2,54 crores)	,, 8 ,,
TOTAL ..	Rs23 crores.

This estimate is not only a very rough one but also ignores certain other kinds of long-term investments, particularly in precious metals. It may, therefore, be tentatively suggested that the annual investment of the Calcutta capital market will not be less than Rs23 crores and may be put at about Rs25 crores. It is, however, necessary to emphasize that in view of the various difficulties already mentioned, and particularly in the absence of necessary statistical materials, this estimate can only be very tentative.

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